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Deputy Prime Minister and Minister of Finance of Belgium

Jean-Claude TRICHET
President of the European Central Bank

The Euro, the investors and the governance

Tommaso Padoa-Schioppa, this convinced and far-seeing European with his deep interest in economic and financial issues, dedicated a large portion of his life to both the European currency and the management of global monetary affairs. To pay tribute to him, *Notre Europe* and the Egmont Institute joined together to organise a seminar entitled "The Euro, the investors and the governance". The seminar, held in Brussels on 4 April 2011 in the presence of some sixty personalities, allowed us to address issues that have been the subject of passionate debate since the global financial crisis first rocked the euro zone.

Overall, Firstly, to conduct a thorough assessment of the project undertaken in 1999, while clearly separating the first nine years from the 2008-2011 period. Secondly, to respond to the doubt financial and monetary specialists have placed upon the future of the euro. What do investors expect from a common European currency? What do they dislike about the current system? Do they have any proposals for reform, be they institutional or technical? Finally, the third objective was to ascertain what type of EU governance will be able to guarantee both euro zone stability and European Union economic and social development (i.e. job creation, competitiveness and purchasing power).

This publication, a collection of the speakers' interventions, draws an outline of possible answers to these fundamental questions.

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Notre Europe

Notre Europe *is an independent think tank devoted to European integration. Under the guidance of Jacques Delors, who created Notre Europe in 1996, the association aims to "think a united Europe."*

Our ambition is to contribute to the current public debate by producing analyses and pertinent policy proposals that strive for a closer union of the peoples of Europe. We are equally devoted to promoting the active engagement of citizens and civil society in the process of community construction and the creation of a European public space.

In this vein, the staff of Notre Europe *directs research projects; produces and disseminates analyses in the form of short notes, studies, and articles; and organises public debates and seminars. Its analyses and proposals are concentrated around four themes:*

• *Visions of Europe: The community method, the enlargement and deepening of the EU and the European project as a whole are a work in constant progress.* Notre Europe *provides in-depth analysis and proposals that help find a path through the multitude of Europe's possible futures.*

• *European Democracy in Action: Democracy is an everyday priority.* Notre Europe *believes that European integration is a matter for every citizen, actor of civil society* *and level of authority within the Union.* Notre Europe *therefore seeks to identify and promote ways of further democratising European governance.*

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• Europe and World Governance: As an original model of governance in an increasingly open world, the European Union has a role to play on the international scene and in matters of world governance. Notre Europe *seeks to help define this role.*

Notre Europe *aims for complete freedom of thought and works in the spirit of the public good. It is for this reason that all of* Notre Europe*'s publications are available for free from our website, in both French and English: www.notre-europe.eu. Its Presidents have been successively, Jacques Delors (1996-2004), Pascal Lamy (2004-05), Tommaso Padoa-Schioppa (2005-2010) and António Vitorino (since June 2011).*

The Egmont Institute

The Royal Institute for International Relations is an independent think-tank based in Brussels. Drawing on the expertise of its own research fellows, as well as that of external specialists, it provides analysis and suggests international policy options that are meant to be as operational as possible. Conferences, colloquia and seminars nurture the work of the research fellows and give participants the opportunity to exchange views with other specialists and with a well-informed public made up of representatives of the political, economic and academic spheres, as well as of the media and civil society. Closer cooperation with other research centers, both in Belgium, in Europe and beyond, has resulted in a growing number of joint conferences and in more structured research and publication activities. This policy has been mutually beneficial for the Egmont Institute and its partners.

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The Euro, the investors and the governance

Introduction

Jacques Delors

Tommaso Padoa-Schioppa devoted a large part of his life to working on the European currency and global monetary organisation. His commitment to resolving the crisis that has been affecting the euro zone since 2009 did not come as such a surprise. Learning from past experience and stimulated by his vision of a future at once both uncertain and flexible, Tommaso fought to make the – somewhat lost – voice of Europe's fathers heard, and to put forward effective and lasting solutions accompanied by proposals for strengthening the Economic and Monetary Union (EMU).

To pay tribute to this convinced and far-seeing European with his deep interest in economic and financial issues, *Notre Europe* and the Egmont Institute joined together to organise a seminar on "The Euro, the investors and the governance". The seminar, held in Brussels on 4 April 2011 in the presence of some sixty personalities, allowed us to address issues that have been the subject of passionate debate since the global financial crisis first rocked the euro zone.

The seminar was held "behind closed doors" in order to allow the speakers, the debate chairs and participants in general to voice their views freely and without fear of being quoted outside the seminar venue. I would like to take this opportunity to thank them again for the quality of their contributions to this collective discussion. This book contains only the addresses delivered at the seminar by the nine official speakers, with their agreement. It falls to me here to echo their thoughts and to summarize the debates triggered by their speeches, going on to then illustrate the lessons that I myself have learnt from them.

Any debate on the issues currently at stake in, and the solutions to be adopted for, the euro crisis must rest on an objective and stringent assessment of the experience that began in 1999, distinguishing the nine years before the crisis from the years 2008-11. Thus the seminar's first round table endeavoured to review the EMU's track record with speeches from Chairman Jean-Claude Trichet, Governor Mario Draghi and Germany's Peter Bofinger, a member of the "council of five wise men".

Taking stock is neither an easy nor an obvious exercise. The result is going to depend both on the way we look at things and on those aspects to which we assign a positive value.

The EMU was seen as a huge success ten years after its creation, and before the global financial crisis struck. The euro succeeded in rapidly winning market confidence and in getting established as the most important reserve and international transaction currency. Price stability was ensured, and member states were able to enjoy low interest rates. The euro gave Europe ten years of acceptable growth, with an average growth rate of 2.1% and the creation of 15% more jobs.

As Jean Boissonat, the debate's chair, explained, the public debt crisis had an edifying impact: it revealed the EMU's strengths, but above all its weaknesses. The speakers highlighted four of the latter in particular.

Firstly, the budget oversight framework offered by the Stability and Growth Pact was not sufficiently stringent. Several countries failed to meet the Pact's requirements without suffering any particular consequence for having done so.

Secondly, economic union, which was intended to complete monetary union, was non-existent. The absence of either economic policy coordination or macro-economic oversight meant that the EMU proved incapable of preventing major macroeconomic imbalances among the countries in the euro zone.

Thirdly, the EU suffered from the inconsistency between a globalized bank system and national financial oversight mechanisms.

Finally, the EU had no crisis-resolving mechanism before the crisis, so it had to create one riding on the back of the emergency.

Yet the crisis did not reveal only the EMU's weaknesses, it also allowed member states to become aware of the interdependence that exists among the countries in the euro zone. The problem any given member state is facing cannot be limited to its borders; it affects the euro zone in its entirety. Thus the challenge that the European institutions and member states are now facing consists in creating appropriate oversight and coordination mechanisms in an effort to consolidate the limited shareout of sovereignties among the member states.

The EU has taken a firm stance on managing and resolving the crisis. Even though it has been criticized for taking a long time before swinging into action, numerous participants pointed out that the time-frame of democracy is longer than the time-frame of the markets, and that the responses given to the crisis must therefore be afforded proper consideration.

The debate organised during the seminar's second round table addressed the role and expectations of investors *vis-à-vis* the euro. François Lenglet opened the debate by pointing out that investors must not be seen as adversaries in the management of the crisis, and that it is important to foster dialogue between the players in the market place and the political decision-makers.

Investors were represented at this debate by Philippe Lagayette and Erik Nielsen. Their speeches were accompanied by an address from a leading political player and expert on these issues, Commissioner Michel Barnier.

The speeches pointed up the urgency of re-establishing confidence in the European banking system. This involves, in the short term, conducting a clear diagnosis of the situation in the industry through stress tests whose crediblity is boosted both by more stringent conditions than those laid down after the first series of tests, and by the improved coordination provided by the new European Banking Authority. The tests must be a success and they must teach us a few lessons, prompting the adoption of the measures required to aid struggling banks to recover.

Despite the sweeping reforms of the past few months, the new financial oversight framework has to be strengthened even further. In particular, the powers of oversight of the new authorities which have just been set up must be strengthened.

Moreover, there are certain problems that have not been resolved yet, the speakers stressing in particular the regulation of bank bankruptcy and of rating agencies in this regard. The Commission must devise proposals designed to allow the implementation of the ground rules enshrined in “Basel III” and a tool box for the prevention and resolution of bank crises.

The issue that produced the widest rift among the participants concerned whether or not a country in the euro zone should be allowed to restructure its debt. On the one hand, a fair number of economists and investors argued that we must distinguish between liquidity and solvency problems and that we must allow for the possibility of an ordered restructuring of the public debt. Representatives of the European institutions, on the other hand, argued that it is not consistent to adopt serious financial and budget measures while announcing the hypothesis of some kind of “plan B” – debt restructuring – more or less in the same breath, because statements of that kind would undermine the credibility of the measures anounced and render them ineffective.

The benefits that would result from the issue of euro-bonds up to a certain figure (for instance, up the existing debt level or up to 60% of GDP) to fund national debts were mentioned. In that context, it was stressed that euro-bonds would have a positive impact, including for Germany, by guaranteeing greater solvency and liquidity. Those opposed to the idea pointed out that the European Financial Stability Fund and the European Stability Mechanism were already extremely difficult to achieve, even separating the risks, and that therefore the mutualization of risks through the issue of euro-bonds sounds unrealistic. Besides, euro-bonds would be a huge step forward down the path leading to mutualization of a federal nature, which the member states are not yet ready to accept as things stand today.

The third round table focused on the EMU’s future. Jean-Hervé Lorenzi, who chaired the debate, stressed that even though we are only now taking our first steps in the direction of genuine European economic governance, we will realize in a few years’ time, when looking back, that the years 2010 and 2011 were exceptional years in terms of the proposals and decisions made. But we have not yet reached the end of our journey, hence the need to continue debating Europe’s economic governance.

The debate was enhanced by speeches from Deputy Prime Minister Didier Reynders, from Mario Monti and from Jean-Pisani-Ferry.

The upshot was that budgetary consolidation is only one factor, albeit a crucial one, in emerging from the crisis. It is essential today to reconcile the return to stability with a growth strategy, so as to be able to respond to the dual criticism of markets clamouring both for a reduction in public and private indebtment and, at the same time, for a reduction in the risk of economic stagnation in the event of excessive budgetary stringency.

Speakers mentioned two crucial conditions for imparting a fresh boost to growth in Europe: structural reforms, and a strengthening of the single market.

On the one hand, structural reforms are essential in order both to strengthen competitiveness, and to cover a weakness in the European economies consisting of relatively weak overall productivity. It was pointed out that structural reforms are not being implemented with sufficient vigour today, when in fact they should go hand in hand with healthy budget policies.

This issue brings us to the importance of considering not only the level but also the quality of public spending. It is best to distinguish between consumption spending and investment spending, because countries should be making investments designed to empower future growth.

In this context, the “Euro-Plus Pact” was greeted with enthusiasm because it may make it possible to bring forward the reforms needed to impart a fresh thrust to growth. The challenge facing us now is that the member states must prove as committed to its implementation as they have been to its adoption.

On the other hand, it was emphasized that the single market is an essential trump card for relaunching growth. In the context of Europe’s new economic governance, we cannot assign the EU a role consisting merely of overseeing and coordinating national economic policies. The EU must be a fully-fledged player in the relaunch of growth: its role is linked principally to the modernization and deepening of the single market, which has been and still is one of the principle driving forces behind growth in Europe.

The member states have learned their lessons from the crisis and they have taken the ambitious decision to strengthen the EMU, particularly through imparting new strength to the Stability and Growth Pact in the shape of gradual but more automatic sanctions, of a new macro-economic oversight procedure, and of a strengthening of the follow-up on structural reforms in the context of the “Euro-Plus Pact”. All of this represents considerable progress, but we should emphasize that it marks only the beginning of the path down which we need to travel. The most important thing will be implementing in concrete terms the measures being contemplated today, and implementing them in the long term. This year of reforms must be followed by those reforms’ equally intense implementation, and more especially by a genuine display of commitment on the member states’ part.

The member states will naturally be playing the leading role in the implementation of the measures adopted. The Commission is going to have to play a role based on initiative, follow-up and assessment. However, while bearing in mind the importance of actions undertaken at the national level, a proposal was also put forward to strengthen the Eurogroup’s powers and to extend its sphere of action. Thus the Eurogroup chairman could enjoy stronger powers in verifying that engagements entered into (in the framework of the Stability and Growth Pact or of the Euro-Plus Pact) are honoured. In addition to this, the Eurogroup could be developed further by planning meetings no longer devoted solely to economic, financial and monetary issues. Ministers with responsibility for areas of importance in the fields of competitiveness and growth, such as employment, research, transportation, welfare or education, should also hold meetings 17-strong.

The creation of a permanent crisis-resolving tool, the European Stability Mechanism, was welcomed by most participants, although several weak points were identified. The mechanism can kick in only as a last resort, it is subject to a unanimous vote and it is bounded by numerous terms and conditions, and it will not be able to buy up debts on the secondary market. A number of participants highlighted the fact that this new mechanism should be allowed to intervene sooner in order to facilitate the adoption of programmes for the consolidation of public finances.

Finally, it was pointed out that the public debt crisis has also triggered a political crisis, which is translating in particular into the rise of populism in numerous countries. This movement may be fuelled by the enforcement of austerity measures, by lack of growth and job creation, or by the feeling that one is paying for others’ mistakes. But this political crisis is due also to a communication problem and to the temptation to turn the euro into a scapegoat. If the EU is to counter the rise of populism, it also needs to learn to improve the way in which it communicates what it does and the progress it is making.

Tommaso Padoa-Schioppa thought that the deepest roots of the current crisis should be sought in shortsightedness, “the kind of sight, as Dante put it, that does not extend beyond a single issue, a shortening of the horizon on which the markets, governments, communication, businesses and even the man in the street, train their gaze”. Our hope is that the collective debate conducted during this seminar may encourage people to cast their gaze beyond the short term and the immediate issues. As Jean Boissonat pointed out, we have to address this crisis with confidence because, as Jean Monnet said, “Europe will be forged in crises and it will be the sum of the solutions adopted for those crises”.

In a nutshell, we must carry on the struggle of the past sixty and more years for a Europe united in diversity, a Europe at once strong, just and generous.

1ST ROUND TABLE

WHICH ASSESSMENT FOR THE ECONOMIC AND MONETARY UNION?

Chaired by Jean Boissonnat,
journalist and economist

For a more efficient economic governance

Jean-Claude Trichet, *President of the European Central Bank*

Let me begin by thanking *Notre Europe* and the Egmont Institute for the invitation to this conference today in honour of Tommaso Padoa-Schioppa.

Tommaso was a man of culture, a man of vision and a man of action. I had the privilege, during a great number of years, to work close to him in different positions and then to work with him in the Executive Board of the European Central Bank (ECB). In the Executive Board he did marvels, particularly in the area of international relations where his tireless activity permitted many advances, in the domain of payment systems in which he had acquired in Basel the best global expertise, and in the crucial dimension of financial stability where his diagnosis on our global and European institutional weaknesses proved unfortunately to be prophetic.

But, overall, Tommaso was a European, a militant of the European Union's historical endeavour. And although it is with a heavy heart, it is inspiring to speak on a subject that was so dear to him and so central to his life's work.

Let me also remind us that I am in the purdah period, and nothing I will say can be interpreted in terms of future monetary policy.

We all know that the Chinese leader Zhou Enlai, when asked in 1971 about the impact of the French revolution, famously replied that it was "too early to tell".

What Zhou Enlai confirmed in this comment is the difficulty of making assessments of historical processes at a particular point in time. There is always a risk of being too influenced by the circumstances of the present. This can lead to judgments that lack an appropriate, encompassing perspective.

The same remarks apply when assessing the Economic and Monetary Union (EMU) at a particular point in time.

To avoid the trap of being over-influenced by the present, a broader framework for assessing EMU is needed. To this end, I would like to draw on a framework put forward by French historian Fernand Braudel.

In his seminal study of the development of social structures in Europe, Braudel identified three levels of time which are necessary to understand historical change. The first level was the *longue durée*: the deep processes over long periods that shape the structures of economy and society. Such a long term perspective is important to assess EMU because a key objective is to further the historic project of European integration.

The second level of time was the *époque*: the trends that define a particular period of history. This medium-term perspective is also relevant because the Treaty has set aims for EMU which are best assessed over the medium-term – most notably ensuring price stability.

The third level was *l'histoire événementielle*: the events of the day that shaped the course of current affairs. This near term perspective is significant because the litmus test of any union is how it responds to unforeseen stresses and challenges – and EMU has experienced just such circumstances together with all advanced economies since 2007.

Such a textured approach may give a more comprehensive picture of EMU. I will discuss each level in turn.

The *longue durée*

Let me start with the long-term perspective, the *longue durée*. For Braudel the *longue durée* concerned the slow and subtle effects of deep social and economic changes. It is an important perspective because EMU is part of a historical process to deepen economic integration in Europe, and thereby, as Montesquieu famously argued, to make the countries of Europe "*reciprocally dependent; and their union is founded on mutual necessities"*.

It would be fair to say that this ambitious aim has been achieved. The ideas for the start of a European Community, presented as early as in the speech of Robert Schumann in 1950, for an economic and monetary union laid out in the Werner Report in 1971 and then in the Delors Report in 1988 have become reality. Going further back, a single market with a single currency represents – to various degrees – the fulfilment of the visions of thinkers like Victor Hugo in the 19th century, Immanuel Kant in the 18th century, Hugo Grotius in the 17th century, and Erasmus in the 16th century. EMU has brought economic gains and thereby help lay the foundations for "perpetual peace" in Europe.

This wish for deeper integration is not only a philosophical pretension but also evident in the attitudes of European citizens. Surveys indicate that, on average in euro area countries, more than 80 per cent of euro area citizens are in favour of greater policy coordination between countries to overcome the crisis. This suggests that European integration has led Europe's citizens to fundamentally reappraise the value of cooperation in difficult times. EMU constitutes the *avant garde* of this long term historical process.

It is important to keep in mind this long term perspective, looking beyond the ongoing economic and financial challenges in the euro area. EMU is an unprecedented achievement in history of sovereign nations. Euro area countries have voluntarily chosen to share sovereignty for the sake of common goals.

The *époque*

Let me now turn to the *epochal* view. The *epoch* in Braudel's view is a period of time over which medium term trends can be meaningfully assessed. The medium term for central banks, as regards the definition of price stability, is a duration of several years. Therefore the 12 years since the launch of EMU is an appropriate length of time to allow for a review of whether medium term goals have been met.

As regards Monetary Union the first aim is price stability, the primary mandate of the ECB. The ECB Governing Council has defined price stability as an annual increase in consumer prices of below 2%, but close to 2%, over the medium term. Since the launch of EMU the average annual inflation rate in the euro area has been 1.97%. This is a better performance than any large European economy over the last 50 years. It has also helped the euro establish itself as the second-most important international reserve and transaction currency, trusted by financial markets.

This has been possible because the ECB's actions were enshrined in a medium-term oriented monetary policy strategy. Our definition of price stability is the needle in our compass and has guided the steady course of monetary policy over the last 12 years.

On a consolidated basis the euro area performed well in terms of growth and employment, also in an international comparison. Adjusted for differences in population growth, *per capita* GDP growth in the euro area over the last decade has been almost the same as in the United States, at about 1% per year. As regards the dispersion of real GDP growth rates across euro area countries, they are comparable to the equivalent dispersion between the states of the U.S. On employment, the euro area made significant progress as well, with overall employment increasing by 14 million during the first twelve years, compared with a rise in employment of about 8 million in the United States. And the overall yearly public finance deficit is presently about half of that in the U.S. or in Japan.

However, the crisis has revealed that not all of these gains in all countries were sustainable or balanced. Some euro area countries did not follow rules for the conduct of national economic policies. Between 1999 and 2008 significant fiscal and broader macroeconomic imbalances appeared.

In a stability-orientated economic and monetary union, countries have to keep their fiscal house in order. Fiscal and broader macroeconomic policies have to keep domestic demand in line with rates of sustainable growth and price stability. Otherwise the result will be escalating unit labour costs, increases in public and private debt and losses in competitiveness.

So if I sum up the *époque* from the start of the euro until the global crisis, during the first nine years of the euro I would say that we could observe a remarkable success of monetary union as a whole and a much less flattering behaviour of the economic union, both because a number of countries were not respecting individually the rules of the Stability and Growth Pact, and also because all member countries collectively did not exert the surveillance, which was commanded by the Pact.

In that sense, the global crisis, which intensified in 2008, has acted as revelatory. It marks the end of the first *époque*.

More than before, from now on it appears absolutely essential that all euro area countries adhere to the ambitious fiscal consolidation plans to which they have committed in front of their peers and restore the confidence of firms, households and investors in the soundness of public finances. Fiscal consolidation is an essential first step on the path back to sustainable and balanced growth in the countries concerned, and ultimately to achieve the objectives of the Treaty and the expectations of European citizens. It is equally essential that all euro area countries create a strong surveillance of their competitiveness indicators and of their imbalances as a second "pillar" of their governance.

The *histoire événementielle*

Now let me turn to the near-term perspective, *l'histoire événementielle*. For Braudel this period of time concerned "events, politics and people" and how their real time activities shaped the course of history. This is a significant perspective because EMU is a "community of destiny" that is responsible for taking measures to ensure the best interests of its citizens. Thus an assessment of EMU has to take into account how it responds to and manages challenges.

The severe challenges since 2007 and, more particularly, since the intensification of the crisis, in September 2008, have provided EMU, as well as all advanced economies, with the toughest global test since at least 65 years.

EU policy makers have so far responded to these testing times effectively.

The ECB has been fully faithful to its primary mandate, price stability, in deciding on interest rates, its standard policy measures. And, taking into account that the financial crisis was hampering the normal transmission of its monetary policy, it has decided a number of non-standard measures to help restore a more normal function of this transmission.

Member States also took important measures. No systemically important financial institution in the euro area was allowed to fail. All euro area countries undertook ambitious fiscal consolidation. Two stability facilities with a total volume of €500bn were established.

And these achievements have to be set in context. Observers often compare EMU with a unitary state like the U.S. and Japan and expect similar policy responses. Yet EMU remains a union of sovereign states that has its own logic for addressing challenges. This leads to outcomes that are not always linear. Seen in this light, EMU's response seems all the more impressive.

Indeed, one should not exaggerate the differences, as regards diversity of economic behaviour of member economies, between a fully fledged political federation like the US and the Euro area. As I mentioned before, the difference between the fastest and slowest-growing U.S. states is not of a different order of magnitude as that between euro area countries. For instance, between Oklahoma and Nevada there was a 13% difference in growth in 2009; between Slovakia and Ireland the difference, which was the highest that year, was around 9% in 2008. The same is true of employment. In 2009 the largest difference in unemployment in the euro area was between Spain, with 18%, and the Netherlands, with 3.7%; for the U.S. between Michigan, with 13.6 %, and North Dakota, with 4.3%.

But, that being said, if a lot has been done in Europe a lot remains to be done in the domain of economic governance. The problems with the economic pillar of EMU that I described above result from weak governance. The solution to these problems involves resolutely strengthening economic union by a major change in its governance. As I said, we need to make a "quantum leap" by both reinforcing the fiscal pillar of governance, which is the Stability and Growth Pact, and by creating a new pillar of governance, namely a strong surveillance of competitiveness indicators and imbalances. There is a third pillar of governance of the Economic Union in the EMU, which is as important for the European Union as a whole as it is for EMU: the structural reforms embedded in the "Europe 2020" strategy. These structural reforms are essential to elevate the growth potential of the single market of Europe as well as of the single market with a single currency.

The Council has recognised the need for stronger rules for fiscal policy and the necessity of a new surveillance framework for macroeconomic imbalances. But in my view, it does not go far enough.

The proposals currently on the table should be strengthened to reach this very significant jump towards closer economic union that is required. The ECB strongly believes that more ambitious reforms are needed for the euro area and it is convinced that the *Trialogue* between the Council, the Commission and the Parliament will permit the Parliament to significantly improve the texts that were presented to it.

This is much more than a simple procedural concern. Stronger economic governance is essential to support the fundamental construction of EMU. A union with a centralised monetary policy but decentralised economic policies needs appropriate mechanisms to balance the independence of countries and their economic interdependence.

Conclusion

It is essential when discussing Economic and Monetary Union to take an appropriately broad view. EMU is a major step in a major long historical process that cannot be judged solely on the basis of passing events, of *l'histoire événementielle*.

That said, how the euro area responds to the challenges of the *époque* it is currently facing together with all other advanced economies, will influence the historical trajectory of Europe. The key question is whether governments can put in place a very significantly reinforced governance of their economic union in order to reap the full benefits of the single currency. This will determine whether the new *époque* which is ahead of us after the crisis is a time of economic and financial stability, of sustained growth and of sustained job creation. It will also be decisive in giving a direction to the historical evolution of Europe in the perspective of the *longue durée*.

The historical stakes are important. Either we prove that we are able to find the new strong reinforced governance concept, which will fit with a constellation of sovereign states and permit the European Union to face up with the new globalised world. Or, we do not convincingly succeed into this direction, and then a new jump in the institutional framework of Europe toward a political federation will appear necessary.

It is often said that Europe has demonstrated the capacity to make progress when it has to draw lessons from its own difficulties. I find this notion in Jean Monnet's remarks, immediately after the conference of the "six" on 23 July 1952, on the European Coal and Steel Community, almost 60 years ago. At the end of Chapter 14 of his *Mémoires*, he writes: "I told François Fontaine: We have a few hours to rest, and a few months to succeed. Then… Then – said a smiling Fontaine – we will meet great difficulties which we will use to advance further. Is it the right way to look at it? It is exactly the right way. You have understood everything about Europe!"

Tommaso was often mentioning this remark of Jean Monnet when we were discussing together the future of Europe.

More than ever, Europe, coping with the present challenges, needs to demonstrate its sense of direction. This is no time for fatigue. This is no time for complacency.

The Economic and Monetary Union after the crisis

Mario Draghi, *Governor of the Banca d'Italia*

I am very grateful to *Notre Europe* for the invitation to this conference in honour of Tommaso Padoa-Schioppa.

Tommaso has left an indelible mark on the construction of Economic and Monetary Union (EMU); he contributed to the advance of the European Union with the passion of the founding fathers. My personal remembrance goes back to twenty years ago when, as head of the Italian delegation, I participated in the negotiations for the Maastricht Treaty. I had the privilege to meet and exchange views frequently with Tommaso – at the time Deputy Director General of the Bank of Italy. His deep knowledge of the European historical process, his understanding of the problems at hand – he had just made a crucial contribution to the preparation of the Delors Report – and his clear sense of direction were fundamental; Tommaso was the true inspirer of our position. Today, with Europe facing difficult challenges and complex decisions, we greatly miss the clarity of his thinking, his optimism, his determination and his dedication to the European cause.

EMU has had a success beyond even the most optimistic expectations. The euro has established itself as a credible and strong international currency. Internal trade has been fostered, and integrated infrastructures have been created for payment systems in the area. Price stability is today inscribed in the conduct of economic agents, even in countries which were previously the most inflationary: this is the legacy of the best traditions of the participating central banks. Risk premia have come down, low nominal and real interest rates have been granted to all the participating countries.

At the same time, even the most enthusiastic supporters admitted from the start that a number of weaknesses remained in the EMU construction. In many senses, they related to the asymmetry between the construction of the “monetary” part of EMU, basically accomplished, and the incompleteness of the “economic” part, an asymmetry that Tommaso repeatedly pointed out:

- a centralized monetary authority confronted with many, often uncoordinated economic policies;

- a Stability and Growth Pact (SGP) that was defective in the control of public finances and ineffective in fostering policies for growth;

- increasing financial integration in the absence of common rules and supervisory practices, and the lack of procedures to deal with cross border emergencies.

Little progress was made in improving the economic governance of the Union in the period from the adoption of the euro to the recent crisis. This was probably also due to the very success of the euro: the single currency acted as a protective shield, reducing the incentives to converge towards best practices and common benchmarks that had characterized the run-up to its adoption.

The effort to achieve fiscal discipline became less intense; the SGP was weakened precisely when the first signs of its inadequacy had started to appear. The possibility of expanding debt at a low cost not only reduced fiscal prudence, it also led to the underestimation of the divergences among countries, in terms of economic performance and competitiveness, and disequilibria in balances of payments and financial positions.

Monetary stability was not, and could not be, sufficient to achieve financial stability.

The test of EMU’s ability to withstand a major economic shock has come in the form of the worst financial crisis since the Great Depression. I believe that any judgment on the overall solidity of EMU cannot abstract from this consideration. Inevitably, the crisis has amplified some of the weaknesses of the European economic governance that I have just highlighted; uncertainties and even inconsistencies have emerged that have caused delays and difficulties in finding the appropriate measures.

However, if measured against the dramatic intensity of the crisis, in many respects the European answer has been a positive one. The action by the European Central Bank (ECB), with its promptness and flexibility and in conformity with its mandate, has been widely acknowledged. Thanks to the credibility acquired over the years, inflation expectations held firm, allowing the monetary authority to take decisive action, keep the markets working, support lending and avert the collapse of the economy. It should therefore come as no surprise to find the ECB ready to buttress its credibility and act preventively to avoid any slippage in expectations on future price developments.

The Council of the European Union, together with the Commission and the other European institutions, has played an increasingly important role; governments have intensified coordination and agreed on common actions to sustain the financial sector and to provide support, subject to conditionality, to Member States in difficult situations.

Without the Union, such cooperation and coordination in the monetary and economic field would have been almost impossible to achieve, and would not have produced rapid and effective results. Some countries could have been overcome by the crisis.

Most importantly, the crisis has increased awareness of the urgent need to strengthen governance and has prompted a rapid process of reform. In just one year the institutional landscape in Europe has greatly changed.

Let me just briefly discuss a few points regarding these changes.

First, the debt crisis in some European countries has shown how crucial it is to reinforce the rules, multilateral surveillance and the monitoring power of central institutions. Many of the changes agreed upon by the Council – such as introducing the European semester, strengthening the SGP, particularly with regard to the debt criterion, constraining fiscal policy more resolutely and making sanctions more automatic – go in the right direction.

As you know, the ECB has advocated a significantly higher level of automaticity of procedures and sanctions. There is still a risk of too much political discretion remaining in the system, which may cause delays and weaken incentives, a fundamental problem that has affected the operation of multilateral surveillance in Europe in the past.

Moreover, it is now imperative that countries fully translate the new rules and procedures in their own national fiscal frameworks, with appropriate legislative changes. The implementation at national level will be decisive. Indeed, one of the great advantages of participating in the EU is that countries with weaker institutions can more easily internalize the structures and actions that are necessary to achieve stability and sustainable growth.

Second, we now have a mechanism in place to provide financial support, subject to strict conditionality, to Member States faced with a public debt crisis. This is important as the lack of agreed procedures increased the cost and complexity of the debt crisis in some euro area countries. At the same time, it would be a mistake to place too much reliance on such a mechanism, which should remain essentially an instrument of last resort with which to alleviate temporary liquidity problems.

The primary responsibility for a response to a lack of confidence must be at national level. The cost of any deviation from established rules must fall on those who have not respected them, not on others; this is a basic principle that must be preserved if we want to continue to advance together. For this reason it is essential that the features agreed for the European Stability Mechanism – strict conditionality of the financial support to a credible and monitored adjustment plan, a rigorous solvency assessment by the European authorities and the International Monetary Fund and the continued participation of private investors to the financing of a crisis – are applied in a rigorous manner in order to avoid moral hazard and maintain the right set of incentives for both Member States and market participants.

Third, the crisis has shown that concentrating only on fiscal discipline is not sufficient. A system of macroeconomic surveillance to counteract large imbalances in competitiveness and external payments is now being set up. This is a very challenging task at both the theoretical and the practical level, as it involves an improved ability to identify the main risk factors and a more intrusive evaluation of national policies than in the past. It is crucial that Member States commit *ex-ante* to a very open and transparent procedure. It will also be important to concentrate on imbalances that have the potential to create huge costs for the public finances or constitute a risk for financial stability.

Fourth, the new supervisory architecture is in place and the new authorities at the macro and micro level have started operating. In the area of crisis prevention, I expect that a significant contribution will come from the European Systemic Risk Board. Its warnings and recommendations should be used to enhance Europe's ability to act upon identified risks in a much forceful and preventive manner.

The reform should now be complemented by setting up a resolution framework for the banking sector with common rules and procedures, in line with the guidelines that the Financial Stability Board is elaborating at the international level.

In the coming months, it will be imperative to tackle the remaining weaknesses in the financial sector. It is urgent to break up the perverse and persisting link between the fragilities in the banking sector and public budgets. There has been too much focus to date on providing financial support to banks as opposed to pushing ahead with serious restructuring plans. The national authorities must now take up their responsibility in full; they should not count on unlimited support from the ECB since its extraordinary liquidity provision measures are temporary in nature. The new round of stress tests at the European level, coordinated by European Banking Authority, should be an occasion to act to regain the markets' confidence.

Finally, I very much welcome the new emphasis, in the Euro Plus Pact, on structural policies to enhance the growth potential of the European economy. The new version of the Pact entails a broad political commitment to increase competitiveness and employment on the basis of commonly agreed strategies as embodied in the Europe 2020 initiative. It also stresses the key role of the single market in fostering growth and sets out to reinforce it, in particular by proceeding further with the integration and liberalization of the service sector. It is crucial that deeds should now follow the words, since the opposite has unfortunately been true too often in the past.

EMU cannot only be an area in which the single currency circulates; its final objective – and ultimately the measure of its success – is to yield stability and prosperity.

Which assessment for the Economic and Monetary Union?

Peter Bofinger, *Member of the German Council of Economic Experts*

The Greek word "Europe" is composed of the words "wide" and "view". Thus, one can say that Tommaso Padoa-Schioppa was literally a true European. He was extremely visionary and farsighted. At an early stage he identified the "impossible quartet" of the European Monetary System and the need to resolve it by introducing a single currency. A few years later, he remarked that the single currency is something that needs to be realized while reality evolves. More than ever, Europe needs farsighted economists. Thus Tommaso's death leaves a huge gap that cannot be closed for the time being.

The organisers of this seminar asked me to give a review of the performance of the economic and monetary union (EMU). Although I will try to be as objective as possible, I cannot avoid to be somewhat biased, because late in the 1990s I was one of the few German economists who was actively supporting the introduction of the euro. In fact, in 1997, I organised a manifesto in favour of the euro with the support of more than fifty notable German economists.

Looking back to the debates of the 1990s, one cannot avoid asking whether the euro-skepticism from Germany, but also from Anglo-Saxon countries, was right by arguing:

- the time for a monetary union was not ripe,
- Europe was not an optimum currency area, and
- the institutional design of the Maastricht Treaty was insufficient to guarantee stability of the euro.

Analyzing the last 12 years of EMU, one might discover a picture that reminds one of the works of the Dutch artist Maurits Escher. Depending on the direction one looks, one can see completely different objects. From one perspective, one can see angels, from another one sees devils.

One perspective is to regard the euro area as an entity. In this regard, the monetary union has been successful. Especially in relation to the main goal of the European Central Bank (ECB): price stability. In 1992, the German euro critics were convinced that a common central bank would never be able to establish price stability. In contrast with an average inflation rate of below 2%, the ECB has been even more successful than the *Bundesbank*. During the lifetime of the D-Mark, the German central bank was only able to achieve an average inflation rate of 2.7%. While today many observers feel truly uncomfortable with an inflation rate of 2.6% in the euro area, it only demonstrates the ECB's ability to raise the benchmark for price stability.

There is also a second field where the euro area, seen as a whole, has been relatively successful: astonishingly, at least to some of my fellow countrymen, that is the area of public finance. According to the International Monetary Fund, the public sector deficit of the euro area will be 4.6% of GDP in 2011. Of course, this exceeds the 3% limit of the Maastricht Treaty, but still goes below much of the values of other major currency areas in the world. It is less than half of the 10.8% which is expected for the United States and the 9.1% that was projected in January for Japan. If one looks at the debt level, the euro area's debt to GDP ratio will be 87% in 2011, and by that 10 percentage points lower than the US ratio and far away from the 227% that were expected for Japan. Therefore, contrary to what many observers in Germany argue, it is simply not true that a monetary union will necessarily become a "debt union". The tremendous increase in public sector debt levels and deficits all over the globe reflects the fact that in the last few years the world economy has been hit by a perfect storm of financial and economic crises. In order to stabilize the financial system and to compensate its repercussions on the real economy, governments in all countries had no alternative but to increase deficits and debt levels.

But in the same way as one can switch the angle to look at an Escher print, one can assess the euro area much more skeptically by seeing it from the perspective of its member countries. There is no doubt that after a relatively stable period until the end of 2009, four members are now in a very critical situation. And at the same time, at least in Germany, the population is becoming more and more opposed to the euro.

So what went wrong? There is no doubt that the framework of the Stability and Growth Pact has not been sufficiently stringent. Although for a whole decade its deficit had always been higher than the 3% limit of the Maastricht Treaty, Greece was able to avoid sanctions. But this is only one part of the story and in my opinion it is not the most relevant one.

On a quantity basis, Ireland and Spain are the greatest threats for the stability of the euro area. Despite having a very positive fiscal performance in 2007, Ireland and Spain account for 76% of bank exposure to the four problem-countries. In other words, even with the most stringent fiscal policy regime, it would have been impossible to avoid the financial and fiscal disaster of these two countries. This implies that one main flaw of EMU's design is the lack of an integrated banking supervision. With the introduction of a common currency, banks were able to expand the scope of their operations beyond their national borders without incurring a currency risk. In fact, this made it possible to transfer savings from surplus countries, especially in Germany, to finance real estate booms in peripheral countries. But while borders for financial markets were removed, banking supervision firmly remained under national competencies with obviously far too narrow of a focus. In retrospect, one can see that in a functioning monetary union the principle of independence from national influences is not only important for monetary policy, but also for banking supervision. Astonishingly, this lesson has not been learned by European policy makers, so far. In the last few months, they have devoted a tremendous effort to improve the functioning of the Stability and Growth Pact, to avoid excessive imbalances and to make their economies more competitive. But there is no willingness to transfer substantial national competences to an integrated euro area banking supervision.

Let me say some words about Germany's role in the monetary union. If one listens to German policy-makers, one might get the impression that our country's performance has been absolutely flawless. Thus, it would be optimal for the euro area for all countries to become similar to Germany. I doubt whether this is true. In the last decade, Germany's domestic demand has been almost stagnant in real terms, while our exports have increased by more than 70%. Is this something which should become a universal law for the euro area? It is somewhat surprising that, in the mother country of the categorical imperative, politicians are unable to realize that the success of the German model was only possible because other countries were behaving exactly in the opposite way. German wage moderation could only be successful as an isolated strategy. Had it been followed by all member states, the euro area would have ended up in a deflationary process. Thus it is very useful that the Euro-Plus Pact envisages a monitoring of unit labor costs. For a more balanced development of the euro area, it is essential that it is applied in a fully symmetric way, so that it can also identify countries where nominal wage increases are below productivity growth and a compensation for inflation.

There is no doubt that, in the last few months, member states have made great efforts to protect the euro and to make the monetary union more stable in the future. However, all these initiatives have not been able to stabilize the situation. The risk premiums for Greece, Ireland and Portugal are currently at historically high levels, only for Spain the situation has somewhat improved. Target 2 balances of more than 400 billion euro show that banks above all in Ireland, but also in Greece, Portugal and Spain are unable to refinance themselves without a significant support by the ECB.

The financial markets' fears are not unfounded. While heads of state or government have now designed a comprehensive crisis mechanism for after June 2013, there are no strong safeguards to cope with major shocks in the meantime. And given the dire medium-term perspectives for Greece and Ireland, even under the assumption of a successful outcome of their adjustment programs, there is a non-negligible risk that a majority of the population might come to the conclusion that their country will be better off by leaving the euro area.

Tommaso Padoa Schioppa is rightly regarded as one of the fathers of the euro. While working with him last year, I could see his anxiety about the growing instability that could jeopardise the very existence of EMU. Therefore, in a joint op-ed with Tommaso, Henrik Enderlein and André Sapir, which was published in September 2010, we warned that a "wait-and-see" approach for the EMU would be dangerous.

This is as valid today as our recommendations are:

- an orderly procedure for sovereign debt restructuring is needed and

- the European Financial Stability Facility should use its low refinancing rates to reduce the interest-rate burden of highly indebted euro countries.

In other words, what is needed is a grand solution that simultaneously tackles both sovereign debtor problems and national banking systems, all while preventing dangerous contagion effects. This is not an easy task, but the catastrophic events in Japan demonstrated that it is better to cope with risks now then to hope great disasters will not happen.

2ND ROUND TABLE

WHAT DO INVESTORS EXPECT?

Chaired by François Lenglet,
Vice-President of La Tribune

Investors' expectations are rational

Philippe Lagayette, *Vice-Chairman of Barclays Capital Investment Banking France*

I would first like to stress that the questions put to our panel concern investors' expectations rather than the markets' expectations. This may sound as though it is merely a matter of vocabulary, but it is more than that.

Every time we talk about the markets, we are implicitly referring to abstract mechanisms, and it is sorely tempting to shy away from the human aspect. There are many ways of shying away from that aspect, one being to consider the markets as a kind of bottomless reservoir into which we can dip without ever altering its level, just as one can dip into the sea with a bucket and never change its level. But that is not what the markets are; the markets are largely people, they are largely people managing portfolios.

Secondly, we should remember, given that we are talking about the public debt, that Europe is not in the same boat either as the United States or as Japan – the other two major economic powerhouses with a strong currency. Where the United States is concerned, we may recall John Connally saying "the dollar is our currency, but your problem"; the dollar and the dollar markets continue to play a special role, which means that investor behaviour dovetails with the US economic and financial system. Europe and the euro have not created a similar situation. Nor is there any large reservoir of holdings in euro in the world forcing people holding euro to pay attention to the overall value of their assets. That situation does exist for the dollar, on the other hand, and it moulds the conduct of those who hold large amounts of dollars. In Japan's case it is something else: it is the fact that the debt is held largely internally, and it is obviously not the same thing when creditors and taxpayers are basically the same people.

So, what do investors expect and what do they think?

First of all, an investor is generally someone who does not manage his own money but other people's. He manages portfolios, funds, SICAVs or the assets of a bank or a state. Thus he is someone who is answerable for his management, someone who is accountable and who therefore needs to justify his decisions, which must be explainable and rational. Also, from his point of view he obviously has to avoid losses and to maximise profits while minimizing risk, in other words, he has to seek the best possible profitability/risk ratio. So we should not think of investors as mostly speculators, or as people who can turn into speculators overnight. Naturally, if you show them situations that are obviously unrealistic, they are going to react. If someone tells them that "A equals B, it's worth the same" but actually most people think that B is worth less, what are they going to do? They are going to say "if you have any A, give it to me and I'll give you some B in return. You're going to be perfectly happy because you claim it's worth the same, while I, who think that A is worth more, am going to be happy too". That is what happens on the markets if you try to peddle unrealistic evaluations. Now, it is true that there are also cases where self-fulfilling prophesies occur when everyone shares the same opinion, but having said that, it not a widespread occurrence and they tend to be situations that correct themselves anyway.

Overall, the investor is someone who makes an investment, not a loan; he is someone who manages his own assets, his own portfolio, and who manages it on the basis of the rational approach that I have just illustrated.

Let us attempt to apply these simple concepts to the case of the euro investor. The euro is the currency of a group, of a zone comprising 300 million relatively well-off

people. Naturally it is a currency without a country, but it is not a currency without rules. The fact that economic policy coordination among the member countries is not on a par with the monetary link between them does not mean that there are no rules. On the contrary, there were rules, and indeed I would say that there were even more rules due to the fact that there was no policy coordination. When it is impossible to agree or to reach decisions together, what is the logical course of action? You thrash out an agreement up front on a range of very orthodox and conservative approaches in order to minimize the risk. That is exactly what happened with the euro, which was equipped with the Stability Pact. There was no economic decision-making system but there were rules, which meant that everyone had to be very prudent when it came to managing the economy. And the larger the number of countries using the same currency, the more prudent one had to be because the more likely it was that whatever happened in one or the other country would trigger consequences in the group as a whole. That was the situation of the euro. It also meant that throughout the period in which those principles were adhered to, there was enormous confidence in the public debts as a whole, to the point where a situation came into being in which investor evaluations almost totally ignored the risk factor because the cloak of confidence spawned by the existence of the Stability and Growth Pact (SGP) affected everyone. I believe that we cannot call it an inconsistent system. The fact that there were no procedures, no common economic decision-making, did not mean that the system was inconsistent or not viable. It was simply a system in which one had to be aware of the rules and to abide by them.

So what happened? As of 2008 people began to confuse the issue. The panorama offered to investors was altered and on part of the public debt drafted in euro, the primary tool on which portfolio management is based, it became impossible to assess risk in the same way, or to assess it in a totally rational manner. For a certain number of countries, investors began to say: "careful, they can't face their liquidity requirements alone". So something exogenous to the system had to happen. It was not even clear whether they could service their debt without financial collapse. Naturally this was due to the meltdown crisis, but only in part. The initial pact rules were not adhered to; and this, well before the crisis erupted. The episode in 2004, which at the time was probably considered benign, returned to the surface. We should remember that when the French, the Germans and the Italians said in 2004 that they no longer wished to comply with the SGP, it was not an accident, it was an attack on the euro zone rules, it was an attempt to undermine the SGP's legitimacy. A part of the financial or academic world had always attempted to question the euro zone rules, but this was the first time that actual governments attacked them. Now, no one can think that one can do such a thing and get off scot-free. There are consequences, and that fosters uncertainty, which is something investors hate, something the markets hate. It is not that they are not accustomed to managing risks without knowing what the future may hold; obviously that is their job. But by uncertainty we mean something else, something that is difficult to justify in the light of any rational calculation. Thus there are countries in the euro zone in connection with which it is difficult to assess risk, and there is even uncertainty regarding the EMU system, because investors can tell themselves that acceptance and implementation of the disciplinary measures required for 17 different countries to use the same currency are no longer the general rule. They also tell themselves that the principle of a rapid return to convergence after a country has strayed is, of course, on everyone's lips but that it is going to be difficult to implement in practice. It is going to be difficult to implement in practice in some cases because it is not sufficient simply to reconverge; one has to ask oneself whether economic development conditions are going to match even if convergence is achieved.

Thirdly, it is necessary to consolidate the return to convergence, and to do so without the investor being made to pay for the poor management of public finances in the country in question. It becomes a whole new ball game if it is the investor who is made to pay. This, especially if it is alleged that he has to pay not only because it is an accident that he should have seen coming, but also as a matter of principle, in an attempt to make investors less trusting in the future. Anyone can see that that would trigger a basic change in future investor behaviour: the public debt in certain euro zone member countries would no longer be seen as the sovereign debt of a well-managed monetary zone, but as the credit risk of an issuer whose credibility has been badly undermined.

So the question is: are we really putting in place the right conditions for the gradual elimination of further sources of uncertainty in the euro zone? If we fail to do this, the markets are going to vacillate more, they are going to respond more brutally, and not only will we no longer enjoy the conditions we had in the past decade, we will also end up with something that is far more difficult to manage. Of course the euro is going to remain a good currency, the currency of the euro zone's central area, but a certain number of countries are going to be treated like credit risks if they continue to use that currency.

Is a situation of that kind going to impact investors' attitude towards the heart of the euro zone? That is a debatable issue, because you can see the glass either half-full or half-empty. On the positive side, there is the fact that no one will harbour any illusions any longer on how to assess the credit risk; that is unquestionably healthier because it is not a good thing for indebtment to be too easy. Indeed, that is exactly the thing that triggered excessive budgetary conduct. On the other hand, there are negative effects which might be, for instance, the idea that it is necessary to be wary of the euro zone because it is a place where overall governance of the economy is not clear, is not in harmony with the currency's requirements, and where disciplinary measures are insufficient. And what is more, that might combine with insufficient growth. And sure enough, structural reforms are not being implemented with sufficient intensity. That is when certain reservations kick in and can affect the euro zone as a whole. But the last word has not been written and there is still time to put things back on track, as long as we are aware of the stakes involved.

The European crisis: A view from the market

Erik Nielsen, *Former Chief European Economist of Goldman Sachs*

Market participants rarely agree on the effects on assets prices and exchange rates of economic and political events, but the degree to which they have disagreed on key aspects of recent years' European crisis is extra-ordinary in several aspects. Roughly speaking, one can identify at least three dimensions to the market's views of the euro zone crisis: First, the majority of US and UK based investors – as opposed to the vast majority of Continental European and institutional Asian investors – initially saw the crisis as existential for the Euro-zone; i.e. (in the "Anglo-Saxon" interpretation) this was the beginning of the inevitable break-up of the Euro-zone. As a result, the early stage of the crisis was characterised by the sell-off of the euro, but as time went by and senior European policymakers made clear that they stand behind the European project and as no serious voice emerged anywhere in the euro zone arguing for anyone abandoning the Euro, this view began to fade. As a result the Euro has strengthened recently even as more countries –Ireland and Portugal– received rescue packages.

Second, there has been an important difference in the approach to the analysis of the crisis between "traditional G-7 investors" and "dedicated EM investors", with the former group originally underestimating the severity of the fiscal crises, while the latter group –being more experienced in debt sustainability analysis– more accurately saw the severity of the sovereign debt dynamics. However, the latter group typically underestimated the determination (and power) of the official sector, particularly the European Central Bank (ECB).

Third, so-called "real money" investors reacted differently than hedge fund investors, as the former group originally appeared too dependent on the credit ratings agencies and the agencies' late recognition of the underlying weaknesses in parts of the periphery. As the downgrades began to roll along (at an impressive speed) real money managers often got caught and began to hedge themselves in the Credit Default Swap market, accelerating the spread-widening which further complicated matters for the sovereigns.

On the back of these broad characterisations of groups of market participants, I'll focus on three aspects of the crisis, namely the causes of the crisis; the policy responses to the crisis; and the issues which need to be addressed to create a sustainable solution for the euro zone. These three aspects are of particular importance as market participants – with their varying backgrounds and mandates – continue to engage in the eternal probability game: Trying to interpret new information – economics, financial and political – as it became available with a view to guessing the impact on asset prices and exchange rates.

The causes of the crisis

Most importantly, one must recognise that the crisis was triggered not by one or two single events, but by an unfortunate combination of several factors. I can think of at least five such factors, all of which would need to be addressed to lower the probability of another crisis coming around. In no particular order:

First, the world's key central banks kept interest rates too low for too long, providing a period of too cheap money for too long. It is not clear to me why the world's central banks made this mistake, but the last 10-15 years of inflation targeting may be part of the explanation as the focus was on headline (or core) inflation during a period where Europe (and the US) imported significant disinflation from emerging markets and therefore mostly dismissed the excessive credit growth even though it fuelled asset price bubbles. In Europe, cheap money fuelled housing in most countries and – further powered by the collapse in sovereign spreads following the adoption of the euro – the entire euro zone periphery saw excessive increases in public sector wage bills (as their interest bills fell with lower rates), fuelling private sector wage growth and a de-link of wages from productivity; the now much discussed explosion in unit labour costs.

Second, credit rating agencies proved insufficient in understanding the underlying imbalances as they developed in the periphery. Most importantly, the creditworthiness of sovereigns inside the euro zone was (apparently) misunderstood, as was the importance of private sector balance sheets. (For good order, the ratings agencies were not the only ones misjudging these developments).

Third, insufficient regulation and supervision of the financial sector added to the underlying problem of too easy money as leverage grew quickly. And the decentralised supervisory regime inside the Euro-zone aggravated the problems.

Fourth, regardless of the macro and regulatory environment, in several cases, individual financial sector participants did not have sufficient internal risk management processes in place to shelter their institutions from adverse developments. As a result, public money had to be employed in several places to prevent systemic risks from developing.

Fifth, official statistics proved insufficient. Greece is the extreme case, of course.

The policy responses

Many market participants and commentators have been critical of the policy reactions both with respect to speed and content. I mostly disagree. Within the realm of political reality I give high marks for the European policy reaction functions. Of course, if one disregards normal processes of checks and balances in democratic systems, in particular with respect to the commitment by politicians of taxpayers' money, then one can usually come up with faster (and sometimes better) solutions to emerging problems. Also, with the strength of hindsight, one can often identify better long term solutions. But, in my view, within the boundaries of political and legal realities, the ECB and key governments, as well as the Commission, reacted well – and sufficiently – to avoid the ultimate financial disaster of a "European Lehman Brothers" event. The often-heard interpretation of policymakers "kicking the can down the road" (used to argue for taking the presumably inevitable debt restructuring up front) is misguided in my opinion. A better narrative would be that policymakers are "buying time" to both provide the crisis countries with an increased (if – in some cases - still small) probability of sufficient adjustment to avoid a debt restructuring, and for the creditors to provision appropriately and hence prepare for a future possible scenario of debt relief. And indeed, along the way, several countries, including Greece, Ireland and Spain have implemented impressive reforms to address the underlying weaknesses.

In my opinion, the one valid concern about the policy reactions relates to the ECB. While I fully compliment them for their first injection of unlimited liquidity, for their fixed-rate-full-allotment policy (instead of more traditional quantitative easing) and for their purchases of sovereign debt in secondary markets, one must recognise that in doing so, the ECB has taken on a quasi-fiscal role (like several other major central banks), which must be reversed at the earliest possible opportunity. Also, the ECB is now a member of the so-called Troika (along with the Commission and the IMF) in setting policy conditionality and monitoring programs when bail-outs have been agreed. As such, the ECB has taken on a role somewhat like a "European IMF". Beyond the most urgent situation, this is not an appropriate role for a central bank, and it should be phased out as soon as possible.

What should be done?

Finally, let me turn to the issue of what needs to be done for the euro zone to survive and – indeed – prosper in the longer term. First, much ado has been made of the claimed inevitability of introducing a degree of fiscal federalism, i.e. tax sharing, between euro zone member states. Clearly, for the foreseeable future, this is politically impossible. But even if politically feasible, would it be economically desirable? I am not convinced. The experience from other currency unions with

greater fiscal transfers is hardly encouraging in terms of getting the weak parts to adjust, as illustrated in Germany, Belgium – and in the US. In contrast, lending money – possibly in combination with debt service relief either through concessional terms or outright debt write-offs – in return for good policy reforms have had a number of successful outcomes. Indeed, there is no substitute for policy reforms to create internationally competitive economies with prudent fiscal policies – and hand-over of unconditional money is certainly not one.

In the euro zone, policies need to be better coordinated, and coordination needs to include attention to private sector balance sheets, competitiveness etc, as now well recognised. But while the new framework for such coordination is welcome, it will always be subject to domestic politics. Therefore, in the longer term, markets need to play their role in terms of pricing different risks differently and in accordance with the underlying fundamentals. And it must be possible for any borrowing entity – a government, a local entity, a bank, a business, a household – to be allowed to default. A market-based economy will not allocate capital efficiently unless lenders know that money can be lost, thereby guiding the pricing of their loans correctly.

The ECB needs to play a more active role in this respect. Specifically, securities accepted by the ECB in its repo operations must be rated according to their true creditworthiness so greater differentiation of haircuts should apply. This cannot be implemented in the middle of the crisis, but longer term, the ECB cannot continue to treat almost identically sovereign credits with vastly different underlying fundamentals. A properly differentiated policy on haircuts will help drive spreads at an earlier stage than in the past (and hence help encourage policy adjustments at an earlier stage) both because of its direct impact on the cost of repo'ing, but also because of the signal it sends to market participants.

These are not huge changes to the euro zone structures, and they don't need to be. More than two thirds of the euro zone economy remains in fundamentally good shape, based on reasonably flexible markets and a generally competitive private sector, which has kept a savings surplus big enough to cover the public sector deficit. The crisis in the euro zone is a reflection not of a fundamental flaw in the system but of past excesses and lack of reforms to adapt to the new globalised world in no more than 10%-20% of the euro zone economy. Such a crisis calls for fine-tuning of the set-up; not of a major overhaul.

How can we recreate the necessary conditions for confidence in Europe?

Michel Barnier, *European Commissioner for Internal Market and Services*

I am very happy to join you here today, to meet with you all again. I would like to say to Jacques Delors and to all of the *Notre Europe* team too that I welcome this tribute to Tommaso Padoa-Schioppa's work.

I was in London on 1 April for a meeting of the International Accounting Standards Board, the international body that theoretically builds convergence on the basis of accounting standards. I have not missed a single one of these meetings since I have been a commissioner, and I would like to say that Tommaso, who was appointed only a few months ago to chair the Board of Trustees, did a fantastic job in the space of only a few months to improve governance and transparency. In objective terms, this is a body where there is a fairly broad margin for progress in the fields of transparency and of governance. Thus he had already covered a major part of that route. We are going to continue plowing in the furrow of what he had begun to do. That was the object of the meeting which I attended in London and at which we naturally paid tribute to his memory.

In his last book, entitled *Against the Short View*, Tommaso urged us to get things into perspective and to look beyond the mere short-term market response. But then, as I attempted to get things into perspective, I found myself wondering whether the excellent question "what do investors expect?" may not be a little different or complementary, and whether we should not in fact be asking ourselves: "what must we do to make the European economy more solid and more dynamic?" In this connection, and without wishing to overquote from Tommaso Padoa-Schioppa, I found a sentence which seems to me to be important in connection with the caricature of liberalism that we have witnessed over the past 20 years. The sentence phrase was this: "One cannot reflect on a way out of the crisis unless one understands the crisis itself. What the economic system has been lacking to date is the framework of ground rules, of government oversight and action which, in a market economy, is the essential complement to individuals' and businesses' free pursuit of profit." When one takes an objective look at the areas on which public intervention has focused, one sees fairly rapidly that for the past 20 years or so the prevailing idea has been, on the contrary, that markets self-regulate, that the more doors and windows one opened, the more one got rid of what little governance there was, the better things would go. The crisis, with its astonishing violence the like of which had not been seen since the start of the 20th century, showed us that we needed to rebuild governance and oversight – not devising regulations for their own sake, but building an intelligent regulatory environment. Besides, this crisis has taught us that that oversight and those ground rules concern both the financial players and the governments, because it is obvious that the fragility of the banks goes hand in hand with the fragility of governments; banks in trouble are a burden on governments, and sovereign debts weigh down in their turn on the banks.

Having rapidly, and on the basis of this penetrating quote from Tommaso Padoa-Schioppa, described the situation which we have been through and from which we are drawing our lessons, our task now is to come up with a few basic answers on how to respond to these risks, these shortcomings. I think that the answer is encompassed in three goals that were set and reiterated by the European Council on 24 and 25 March this year:

1. A financial sector operating on a healthy basis;
2. Sustainable and coordinated fiscal policies;
3. A strengthening of our economic fundamentals, and in particular the consolidation of the single market.

I think that it is absolutely crucial to make progress in these three areas together. We cannot talk about fiscal consolidation alone, just as we cannot talk about growth alone or about reorganizing the financial sector on a healthier basis alone. We have to pursue these three goals together and we have to pursue them in a lasting manner, with an in-depth reform of the euro zone, with the agenda of financial reforms, and of course with a fresh boost to the single market. In all of this we are bound, of course, by a constraint which is that markets move in a far faster time-frame than democracy, yet we need the time-frame of democracy in order to devise solidly-built measures and to get those measures approved by the Parliament and by the Council. The Commission has an important role to play and I think that it is going to maintain its singular and vital role in the future, just as it did some fifteen years ago (and here, Jacques Delors would tell the story better than I can). The fact remains, however, that it is not a decision maker. Its job is to make proposals, and we do this in every sphere, but it is up to the political authorities – the Council on the one hand and the Parliament on the other – to take the decisions.

I would like to briefly review these three points in the response designed to stimulate investment and to consolidate our economy.

Where economic governance is concerned, Europe should learn to better communicate what it does, to more effectively illustrate the progress it is making.

Our partners have a tendency to sum up our efforts in terms of the complexity of our institutions and of the differences in our points of view, and I think that we have to communicate more effectively. I was in China last week and I was struck by my conversations with the Chinese minister and the governor of China's central bank. The first thing they see is our complexity. Naturally, they also see the importance of the market and they would like it to be more solid. But the first questions they ask concern above all their interlocutors' complexity – who does what – and the difficulty they have in seeing that progress. We have to communicate our progress more effectively because it is very real progress.

Naturally I am not going to review the method adopted by the French and Germans to spark the debate and action on the competitiveness pact, but if we take a close look, we can see that real progress has been achieved both for the European

Union and for the euro zone. Bowing to the pressure of economic circumstance, we have adopted the lasting tools that we needed in order the better to govern the economic as a whole and the euro zone in particular. Indeed, this allows me to make a comment on this issue of governance in connection with rating agencies. I find their conduct shocking and I intend to draw some conclusions from that for the third regulation that we are preparing on rating agencies. I do not claim that it is the thermometer that feeds the fever; but we need thermometers that work properly. And we also need to treat the fever. But having said that, I consider it rather surrealistic – and I use the word advisedly – that rating agencies should have downgraded Portugal or Greece at the very moment when those two countries were making a sustained effort, moreover under the supervision of the International Monetary Fund, of the Commission and of the European Central Bank. I can see clearly what lies behind this downgrading of the rating for Portugal and for Greece, but personally I have misgivings about the timing and the method chosen by the agencies in their response, in their downgrading move. I say this because I think that it is going to be one of the factors in the action that we plan to pursue in the third stage of our regulation of these agencies in the future.

Now let us turn to the second part of the answer: the financial sector, its regulation and its correct capitalization. We have made progress in this area, too. For my part, I feel directly responsible for this field within the European Commission, under the authority of President Barroso. The crucial part of this progress was the fairly rapid delivery of the Larosière package on systemic risk with three European authorities and the European Systemic Risk Council. We now have the framework, and because we have that framework, everything we put into it – the bricks that we are going to deliver one by one, player by player, sector by sector, and market by market – are far more likely to form a solid, mutually supportive structure.

The urgent thing today is to rekindle confidence in our banking system and that, in the short term, involves a clear and shared diagnosis of the situation in this sector, which is probably more solid but in which certain players are still too weak. I think that we will succeed – and this is my main message on this issue – if we prove capable of conducting stress tests that enjoy credibility thanks to more stringent terms than the first series of stress tests last year or the year before, and thanks, of course, to proficient coordination on the part of the new bank authority, because these tests are going to be common to the whole of the Union. I think that the European Banking Authority has an outstandingly important role to play in preventing discord between those who think that the tests should go further, those who think that they already go too far, and certain people who are going to avoid adopting the measures required to put their struggling organisations back on an even keel. We need to make sure that those tests are successful and here too, we need to make sure that we learn one lesson after another.

Aside from the tests, which are a form of diagnosis that force us to learn lessons from them, there are two key measures that we are preparing for a properly regulated and better capitalized banking and finance industry. One is the implementation of the ground rules thrashed out in Basel III – that is my main concern between now and the month of June, because I wish to meticulously calibrate these Basel III measures. And at the same time, there is an issue on which I am particularly keen and that is the toolbox for the prevention and resolution of banking crises. All of this – I am referring to the Commission's proposals – will be finished before the end of the summer. Before the summer is out we will have submitted to the decision makers, the Council and the Parliament, the entire corpus of measures implementing the G20 agenda designed to draw lessons from the financial crisis. I am also very concerned, and this is why I am stepping up my visits to our partners who have signed the G20 agenda, that our partners should draw the same conclusions as us and at the same time as us, in order to avoid the risks of regulatory arbitration again in the future.

My third point concerns growth and the confidence that accompanies it. I am rather struck by a crisis about which people are talking less: the political crisis. I am very sensitive to the rise of populism in a large number of countries both large and small. Naturally, it is the consequences of the crisis that explain these reactions, that trigger the risk of fallback and of protectionism whose first casuality would, of course, be the single market. I think that when we consider the measures to be adopted, we need to conduct a lucid debate on the reaction that we need to put in the field in order to counter the current rise in populism, because that is the factor which can cause the whole thing to grind to a halt by nurturing filibustering minorities, or worse, in a large number of countries, and nullifying some of the progress that we are making at the European institution level. I say this because one of the responses that we need to devise to counter this rising populism is obviously the fact that we must not just act or talk about regulation, oversight, governance, or cutting deficits and debts. What we are doing and what many countries, especially Greece, are doing is not sufficient.

We also need to raise the line of people's horizons and to prove that we are busy recreating growth and jobs, and that we are doing this fairly. The popular sentiment which is expressed in this rising populism, and which accounts for it, is clearly linked to the absence of growth and of new jobs. It is also linked to the fact that people feel things are starting over again just like before and that there is no fairness in the effort they are being asked to make. That is why I, for my part, am taking a very close look at what we are going to have to do in order to produce a second framework for salaries and bonuses which, in some cases, I consider to be unwarranted. At a time when some 10% of Europeans are out of a job, I want to personally voice my support for such equitable measures as the taxation of financial transactions in order to meet a certain number of global or worldwide challenges. This is my third point, because I am talking about raising the horizon in terms of growth, obviously in keeping with Mario Monti's lucid recommendations on the single market; I am talking about using our first and foremost trump card in connection with growth, namely our huge market. Given that 60% of our exports, from the smallest to the largest of Europe's countries, are intra-community exports, we need to act in such a way as to ensure that our trade – in goods, in services, in capital and in mobility – becomes easier and freer. That is the job which I have been trying to do under the authority of President Barroso, with twelve of my colleagues, and which we will be concluding after five months of debates, in the course of which I have received 850 contributions from the 27 countries of Europe, through 12 catalysts for modernizing the single market and imbuing it with greater substance, stretching from intellectual property to mobility and from the structuring of investment for small businesses to the single market, and including an issue which is without any doubt the trickiest and the most sensitive issue of all: taxation, VAT, the taxation of energy, and of course the basis of corporate tax.

In conclusion, I would like to say in connection with this issue that there are two expressions which are no longer considered unutterable in polite society; indeed, I believe that we should start to use them and promote their use more. The first is "industrial policy" in the context of the single market's growth and expansion. The second is "reciprocity" with our important US or Chinese partners. So, in order to build this growth and this confidence, I propose that we should continue to act and to respond in three directions: with properly regulated and capitalized financial markets; with proper governance of the economy and of the euro; and lastly, with a boost to the single market. But we need to act in these three areas simultaneously, and in an ongoing and enduring manner if our citizens allow us to do with their vote. We also need to reflect on the means required to resolve or to attenuate the political crisis in EU's 27 member states, a crisis which runs far deeper than many people currently suspect.

3RD ROUND TABLE

FOR A MORE EFFICIENT GOVERNANCE

Chaired by Jean-Hervé Lorenzi,
President of Le Cercle des Economistes

Open issues on economic governance

Mario Monti, *President of the Bocconi University*

I first met Tommaso Padoa-Schioppa in 1962, when we both were students at Bocconi University in Milan. I saw him for the last time on 13 November 2010 in Paris at the *Comité d'orientation* of *Notre Europe*; I will make a brief reference to that below. Between those two dates, I had the privilege of a frequent dialogue with Tommaso, sometimes in the form of close cooperation, often in common fights conducted in the name of a vision – about Italy, Europe, Italy's role in Europe – which was usually the same, although on many occasions it definitely tended to be a minority view.

I will briefly touch upon four aspects of the newly emerging economic governance of the Economic and Monetary Union (EMU) and, more broadly, of the European Union: 1. governance and semesters; 2. governance towards what?; 3. governance of what?; 4. governance by whom?

1. Governance and semesters

I wish to begin with a simple, semantic observation. As the EU entered the first half of 2010, something relevant happened as to what "semester" in fact means to EU governance. Off went the "semester" as an obstacle to good governance of European affairs; at the same time, entered the scene the "semester" as a facilitator of good governance. The first fact was the result of a deliberate institutional change, the Lisbon Treaty, which put in place a permanent President of the European Council. The second fact, the "European semester" which will now occupy the minds and the policy processes of Member States and the Community institutions during the first half of each year, was not, of course, the result of mere voluntarism. Whereas such innovation had been proposed by the European Commission for years and it was always rejected, in 2010 it has been accepted, due to the pressure of the crisis. But, I see a link between the two facts, because I am convinced that the emergence of the permanent President of the European Council, by exercising authority in a discrete but continuous way, has allowed the EU to draw lessons and to work out policy responses and reforms, in terms of improved governance, more effectively and more rapidly than it would have been possible if we still had the rotation of the President of the European Council. I think this should not be neglected. In a sense, we were "lucky" that the Greek crisis did not appear until a permanent President of the European Council was in place. Incidentally, had the crisis emerged in the course of the first three quarters of 2009, both Greece and Germany – i.e. the two most crucial countries for the management of the crisis – would have seen their margins for key decisions (severe austerity measures, for Greece; adherence to the decision to support Greece, for Germany) further restricted by the imminence of national elections (which took place in September 2009 in Germany and in October 2009 for Greece).

2. Governance towards of what?

The two key words, as regards the objectives, are obviously stability and growth. The objective of stability has been served rather better in the previous Stability and Growth Pact (SGP), where the reference to growth was little more than a lip service. But now the new apparatus makes an unprecedented effort to bring in elements of a growth policy to be coordinated at the EU level and to be instilled into Member states. I refer to the rather disorderly but rich map of instruments – included in the Europe 2020 Strategy and the Euro Plus Pact – where considerable progress has been achieved in providing a framework and some incentives towards growth. In my view, however, insufficient consideration has been given to two fundamental drivers of sustainable growth in the EU economy as a whole: integration and investment. "Integration" is a key vehicle for structural reforms in the Member States. Therefore it is a very important pre-condition for real growth. The Commission has undertaken a major policy initiative to make the Single Market deeper, stronger and more accepted. That initiative, now embodied in the Single Market Act, should become part and parcel of a more organic growth strategy, including a renewed commitment by member States as regards both the implementation of and compliance with existing Single Market rules, and the prompt support in the Council of the new initiatives in the Single Market Act to foster integration. Concerning "investment", I think it is still an under recognised component of European policies. Of course, the growing role of public-private partnerships has to be fully praised. At the same time, I continue to believe – as I first underlined as a member of the Commission in 1996/97 when we "manufactured" the first SGP – that the approach adopted did not, and still does not, recognize to a sufficient extent the nature of the expenditures whereas the sector which makes the expenditure receives an exaggerated attention. Thus, in the original SGP, but even in the Maastricht Treaty before it, the source of evil is the public sector, so any spending made by the public sector - be it current expenditure, be it for investment – is suspect and needs to be capped, in terms of deficit generation; whereas any expenditure made by the private sector is not suspect, irrespective of whether it is private investment, private consumption or even private consumption financed through consumer indebtedness, mortgages, etc. No surprise, then, if we have seen for years considerable discipline put on budgetary development of Member States and a total lack of surveillance or even attention paid to the dynamics of private sector expenditure and private sector indebtedness. It was not an occurrence which should have came by surprise. It came by surprise only because we were to some extend obsessed by a scheme of analysis that gave exclusive role to the distinction by sectors, not by economic nature. Incidentally, that is not in line with another, and earlier, key pillar of European integration. If we look at the former article 295 of the Treaty (number before Lisbon), it stipulates the total neutrality of the EU as regards private or public ownership of companies, but imposes on both privately or publicly held companies the obligation to comply with competition and state aid rules. It is when it comes to creating the single currency – and therefore to protect ourselves from the excesses of the public sector, because historically that had indeed been the main ultimate source of monetary and financial instability in many countries – that a grossly approximated analytical scheme has acquired unique political relevance. This means that Europe is inflicting upon itself an anti growth bias. It is perfectly correct not to pursue growth through the illusions of inflation-creating policies or budget deficits; but I've always seen the merits of putting a very sharp cap on government deficits due to current expenditure but allow for greater room for public sector investment expenditure. I know perfectly well that it is very hard in practice to define what investment is but I maintain that, had we started in 1996/97 to put at work the Commission, Eurostat and the competent services of the Member States with a view to arrive at an agreed, and even extremely stringent definition of what is a worthy public investment, we would now be in a position to apply a policy apparatus that, while protecting Europe and the euro from fiscal profligacy, would do so without penalizing the growth of Europe, thus ultimately the ability of many Member States to comply in a sustainable way to the ceilings on deficit and debt as a proportion of their GDP. This was the point with which Tommaso Padoa-Schioppa concluded his response closing a highly fruitful discussion, stimulated by his thorough and inspired initial presentation, at *Notre Europe*'s *Comité d'Orientation* last November. I had raised this point and he totally agreed and we both went back to the fact that in the initial negotiations for the Maastricht Treaty, Germany had tried to introduce into the Treaty this "golden rule", namely that government indebtedness is allowed, but only to the extent that it finances government investments, not government current expenditures. That was the golden rule that at the time was enshrined in the German constitution, and applied in practice. Incidentally, I consider that rule to be more appropriate than the one that was subsequently introduced in the German constitution (the so called "debt brake"). Tommaso – it emerged clearly from his reply – was now much more favorable to the "golden rule" than he had been in the past, when he was a central banker. He concluded by proposing that *Notre Europe* should promote research specifically on this topic, so that in the future a proper place for public investment may be secured in a EU policy framework for disciplined and sustained growth. Let me add that there is simply no hope in the long term of maintaining the needed budgetary discipline – and perhaps even the necessary consensus on European integration – unless we achieve a more satisfactory growth rate. Finally, more investment-based growth is required if Europe is to fulfill its responsibilities towards future generations. The EU has the merit that it tends to be the ally of future generations, protecting them for example from the degradation of the environment or from excessive public debt. Why then should it not be able to recognize what is in the interest, and what is not in the interest, of future generations in what a government does. Does a government in fact expropriate future generations by financing current expenditures in deficit? Or does it borrow funds to prepare a larger and better endowment of productive and social capital for the future?

3. Governance of what?

As to the scope of governance, we have seen recently, mainly as a result of the crisis, a belated recognition that after all there is a "E", not only a "M" and a "U", in "EMU". Only in the last year or so has it become common to underline that it is necessary to care about economic union not just monetary union. But in my view we are not yet there. Almost everybody now refers to "Economic Union" as meaning the improvement of the coordination of those aspects of economic policies which are not monetary policy. Because monetary policy is a single one, proper governance requires also economic union, they say, in the sense of having more coordination of non monetary policies. Whilst this is of course important, I consider it to be the less important of the two elements of which, in my view, economic union must consist: firstly, a really integrated and fully-fledged single market (the structural component of economic union); secondly, for sure, a high degree of coordination – if not unity – among non-monetary economic policies (the governance component of economic union). To forget the first element would be equivalent to calling "monetary union" a set of countries where there was some coordination among their respective monetary policies, but not a single currency. An economic disunion, an imperfectly integrated economic space, a deficient single market does not become an economic union only because there is, as there should be, coordination of the non monetary aspects of economic policies. Put differently, if we really want the euro zone to be a currency area that approximates, even vaguely, an optimum currency area, we have to have an economic union in the structural sense of the word: a deep market integration. Hence the importance of further steps towards integration, particularly in the services sector. But I would go a step further. There is a seldom recognized paradox: many euro zone countries are behind non euro zone countries; they are holding back the EU's overall competitiveness because they maintain obstacles, and sometimes even create new obstacles, to the full completion and development of the economic union and of the single market. Those of us who are citizens of euro zone countries believe that they are more advanced protagonists of European integration because their countries have embraced monetary union. But that can hardly be regarded as a genuine *avant-garde* if at the same time those countries lag behind in terms of effective participation to the economic union. In fact, countries like the United Kingdom, Denmark, Sweden and many of the new Member States are more complying with existing single market, competition and state-aid rules, and more supportive of new initiatives to foster a competitive single market, than are most of the countries within the euro zone. In a sense, the earlier formidable engines of real economic integration, like Germany and France, have in the last ten year or so turned into brakes. They also seem to be less warm than several non euro zone countries in pressing for more openness in the single market for services, in the single market for energy or in the digital single market. For the above reasons, it is to be welcomed the fact that in the Euro-Plus Pact, for the first time, we see the appearance of some commitments concerning real economic integration and the single market. This is a positive first step. One might even have wished to see a more explicit engagement, like for example: "We, the Heads of State or Government of the euro zone Member States, take the commitment that our respective Member States will be, within one year, at least as compliant as the average of the three non-euro zone Member States showing the best compliance indicators with regard to existing single market rules. In addition, we take the commitment that our respective Member States will strongly support, in the forthcoming negotiations within the different formations of the Council of Ministers and at the European Council, the proposals presented by the Commission in the Single Market Act".

4. Governance by whom?

With 27 Member States, with a permanent President of the European Council, with the declared intention of some Member States (possibly, for the first time, of the largest Member State, witness the recent Bruges speech by Chancellor Angela Merkel) to go beyond the community method, towards a still rather unclear "Union method", the pure symmetries of the community method to which we were accustomed (and which many of those in this room worked hard to implement effectively, impartially and consistently over time) are perhaps a thing of the past (although I still hope that the ineffective and inequitable consequences of abandoning the community method might deter such evolution). So, it is not out of place to look, openly and candidly, at the issue of leadership in the emerging structure of power. At least judging from the decision-making process on the new economic governance, the most crucial and sensitive dossier of recent times, at the top of de facto leadership seems to be Germany, which tries hard – so far – to present its key demands in a blend that can be perceived as much as possible as a Franco-German proposal. Then comes a critically important duo, consisting of the President of the European Council and the President of the Commission, normally working harmoniously to give the proposal at the same time at least a decent degree of conformity with the requirements of Community institutions, laws and traditions; and a substantive acceptability by consensus at the European Council. Three open issues must be mentioned here. First, what will be the long-term consequences, for the consistency and effectiveness of EU policies, of the fact that the power of initiative of the Commission is, substantively if not formally, somewhat constrained, perhaps self-constrained, relative to earlier stages of the European construction? Secondly, to what extent and through which processes will the ascending power and assertiveness of the European Parliament be able to corroborate the quantum of community approach, reinvigorating the Commission's ultimate ability to stick to its mission, and making the final outcomes of an otherwise reinforced intergovernmentalism in fact more acceptable in terms of democratic accountability? Thirdly, can the EU withstand a leadership structure that, as regards Member States, is more asymmetrical than ever before? Here my view is that a German leadership of Europe in terms of political culture, particularly in economic principles and policies, has been there since the early days of the Community. I believe that such leadership has been fundamentally positive, essentially because over the decades it has brought Europe a consistent call, even a flavor, of a longer term, more structural orientation than most of us would have been able to achieve autonomously. My concern is that recently, whilst German influence on the EU has never been greater, that influence is exercised by a Germany which is becoming more and more similar to many other countries, in at least one respect: short-termism in politics, particularly in political decisions on Europe. We have seen, recently, manifestations of some short-termism even in the exercise of discipline. The immediate concern appears to be to satisfy the hunger for discipline of a domestic electorate vis-à-vis which no effort is made to explain that German companies, banks and citizens are after all among the key beneficiaries – we all are – of European integration and of the Euro. Unless this effort is made we are bound, I am afraid, to have a de facto German leadership that, although it has been highly beneficial in the past, risks shaping EU policies in a way that might not be in the long term interest of Europe and Germany alike. It would be regrettable if certain biases were to be introduced in EU policies simply because their objective becomes, so to say, to indemnise a public opinion which sees itself as being penalized by the process of European integration. There are symptoms of this at the present time. Perhaps more leadership at home is a pre-requisite for a more beneficial and accepted leadership in Europe. Those who, like myself, have always seen positively a strong German influence in orienting Europe towards the social market economy, the culture of stability and some sort of *Ordnungspolitikcan* only hope that a more proactive pedagogical effort is undertaken by the political leadership in Germany: not in order to call the public opinion to be more open in terms of solidarity, but simply – and more importantly – to be more open to an attitude of enlightened self-interest.

The weak power syndrome

Jean Pisani-Ferry, *Director of Bruegel*

In his last book, entitled *Against the Short View*, Tommaso Padoa-Schioppa tells us that we should make a distinction between weak power and limited power: “Weak power is power which lacks the tools necessary for it to act in its sphere of authority. Limited power is power whose sphere of authority is limited. Power must be limited, but it must not be weak”. This distinction, so simple yet so powerful, prompted Tommaso to stress that the EU would be complete not because it had been endowed with any additional powers, but once it had been given the means to fully exercise the areas of authority with which the treaties have already endowed it. He added, and it is unquestionably important to bear this in mind as nationalisms go from strength to strength today, that the problem of a weak power is that it fosters despotism.

This distinction sheds a very clear light on the problems of economic governance that the euro zone is facing, also offering us a grid within which to analyse the European Union’s most recent decisions. It can be applied equally well to crisis prevention and to crisis management.

Preventing Crises

The European Union in the first decade of the 21st century was an explicitly weak power in the prevention of crises. It was weak in fiscal surveillance, despite the tool created expressly for the purpose – the Stability and Growth Pact (SGP). It was extremely weak in the sphere of macroeconomic surveillance because the legal tools at its disposal allowed it only to make recommendations. And lastly, its power was virtually nonexistent in the sphere of financial supervision because that area was basically covered at the national level. The result of all this was the failure in supervision which we ended up with, and which led to this crisis.

Yet the EU did not suffer only from a problem of weakness, of insufficiency of means and tools. It also had to face a problem regarding the manner in which the tools available to it were being used. In the sphere of fiscal discipline, the EU did not suffer only from a lack of supervision capability or a weakening of the SGP; it suffered also from a problem regarding the very concept of the SGP, which addressed fiscal risks in a very narrow and entirely deterministic way. This prevented it from revealing the vulnerable areas that emerged during the crisis. The fact that it was only a weak power need certainly not have stood in the way of a little more perspicacity regarding developments in the banking sector and the risks that banking methods might cause, especially in countries where there was strong credit sector development, a major current account deficit, and inflationary trends.

Finally, I get the impression that, even on the basis of the available institutions, nothing need have stood in the way of our displaying a little more courage. As I see it, the Eurogroup's very *raison d'être* was that its chairman could travel to a capital city and, speaking on behalf of the ministers as a whole, say: "your economic policy is causing a problem for the stability of the euro zone as a whole, and we would like to discuss it with you". It was not a matter of legal cognisance, it was a matter of putting the Eurogroup's mandate to good use, however informal that mandate may have been.

Thus the crisis highlighted the need to correct the weaknesses in the governance system. This has been done in connection with various aspects of fiscal surveillance, in particular through the assignation of investigative powers to Eurostat and through a more automatic application of sanctions with the reverse majority rule. The crisis also forced us to wake up to the fact that not all of our problems were budgetary in origin, and thus fiscal surveillance is to be supplemented by vigilance over macroeconomic and macrofinancial imbalances. And lastly, there has been a change in the sphere of supervision with the establishment of agencies, yet their power remains limited.

Where crisis prevention is concerned, power is less weak today, but that has come at the price of a complexity spawned by the multiplicity of procedures required for supervising national economic policies. Three supervision mechanisms – fiscal, macroeconomic and macrofinancial – which partially overlap are going to coexist alongside one another when the trends they are aiming to prevent are identical, or almost. What we have here is a problem regarding the complexity and legibility of this structure, which suggests that a little more curbing might have been necessary. The danger is that the supervision system may prove to be too top-heavy, which will end up exhausting the functionaries and giving nightmares to the ministers called on to run these mechanisms and to explain them to parliamentarians, never mind to the general public.

Thus the euro zone is caught between weakness and limitation. It has not yet achieved a stable balance; for this reason, I would suggest that it is going to have to move in the direction of a greater clarification of areas of responsibility. We need more centralisation in certain areas and less in others. In this connection, several ways of moving forward have been proposed. Where budgets are concerned, the idea of introducing greater fiscal discipline in national decision-making by adopting rules and by reforming budgetary decision-making procedures seems to me to be very important. They are obviously going to be encouraged by the markets. This may allow us in the longer term to combine a Community mechanism, acting as a parapet, with tighter fiscal discipline at the national level. On the other hand, it is going to be necessary to show no weakness in centralising measuring and gauging principles, accounting methods and auditing: all of which will make it possible to ensure that common stability principles prevail despite a decentralisation that will of necessity be tailored to the various different national institutional frameworks.

The effort to decentralise should also see greater involvement on the part of the central bank network. The central banks are players in the national debate in individual member states, and thus they should be empowered to address the issues of financial stability and competitiveness in their national debates on the basis of common accounting methods and principles.

Managing and Resolving Crises

Where the issues of managing and resolving crises are concerned, before the sovereign debt crisis there was simply no power, whether weak or limited. It proved necessary to invent a mechanism for managing and resolving crises, capable of establishing a balance between liquidity supply and the management of situations of insolvency.

For all its shortcomings, the agreement on this issue marked considerable progress, in particular because it prompted a review of the treaty's basic provisions, foremost among which was the famous "no bail out" clause. This clause was interpreted in different ways from one country to the next and it proved necessary to thrash out an agreement on what it meant in practice. It could not be read, on the basis of a restrictive interpretation, as ruling out all possibility of financial assistance, yet at the same time, it had to be accompanied by a reaffirmation of the fact that each country is responsible for its own debts. Striking a balance was a very delicate business, but the EU succeeded.

That said, the EU is in danger of having set up a new weak power by setting constraints on the capacity for action of the European Financial Stability Facility. Confining it to intervening only as a last resort, only when the stability of the euro as a whole is in jeopardy, only by unanimous consent, and within the framework of a program with strict conditionality, strongly contains its capacity for intervention. The EU is steering a course headed in exactly the opposite direction to the course being set by the International Monetary Fund. The IMF in its recent decisions has laid emphasis on the early supply of liquidity, and in only a scantily conditional manner, thus entailing the ability to make rapid decisions. We adopt too many constraints and we create a power that is in danger of being too weak. This weakness can be seen also in the constraint preventing it from intervening on the secondary market.

The same thing may be said about the European Stability Mechanism. In an effort to keep things simple in legal terms, the EU has adopted a contractual approach resting on collective action clauses. These clauses make it possible to address the issue of private creditor aggregation and to avoid appeals in the event of restructuring. But the approach adopted fails to get to the heart of the matter, which is discovering what happens when a country whose debt is mainly held by its partners in the euro zone is prompted to default on its debt, and thus to force its partners to bear a cost. If that happens, it will not simply be a matter of a relationship between a debtor and his private creditors, there will also be a burden that a restructuring of the sovereign debt will enforce on the other member states, which may well be prompted to recapitalise their own banking systems. The Union has set up no legal mechanism for arbitrating in a situation that is in danger of turning into a dispute between member states. Thus once again, we are looking at a weak power.

Finally, I would give you one last, striking example: During the crisis, the European Central Bank (ECB) acted like a strong power in a limited area. We may rejoice over this, but there was one area in which it acted weakly, namely the management of crises in the areas surrounding the euro zone. The ECB's writ does not run in those areas, and so it was unable to act like the Federal Reserve and to forge a series of swap agreements with the countries that had urgent need of liquidity in euro in 2008-2009. Given that action of that kind conducted on a broad scale would have entailed a risk in terms of the central bank's budget, the bank could not take such action without a mandate from the Council, but at the same time it could neither solicit nor receive instructions from the Council. Here we have an instance of weakness for which no remedy has yet been devised.

Conclusion

Considerable progress has been made. By comparison with past experience, 2010 will always be seen as an exceptional year. But the EU's weak power syndrome is still with us. It is still with us for a series of bad reasons, but probably also for a reason which is real, even if it is not a good reason: the single currency has not forged a sufficiently strong sense of belonging for political leaders to be able to use it as a tool. I am talking, of course, about political union, which is a matter of belonging and of solidarity far more than it is an institutional affair.

This brings us to another of Tommaso's books, published in 2004: *The euro and its Central Bank*. In it he wrote: "Ultimately the security on which sound currency assesses its role, rests on a number of elements that only the state, or more broadly, a polity can provide. (...) The euro contains an implicit commitment to the completion of the polity".

That is the issue that we need to address today. It harks back to the debate on political union that Otmar Issing remarks he and Tommaso frequently held. According to Issing, Tommaso argued the viewpoint that we need political union in order to ensure that the single currency is solid, and Issing replied that we would just have to do without. Tommaso was right and Otmar Issing was not wrong. Above all, the most important thing that we can do is to pursue their conversation.

Europe has always moved forward in times of crisis

Didier Reynders, *Deputy Prime Minister and Minister of Finance of Belgium*

Europe has always moved forward in times of crisis.

A monetary crisis in the early nineties led to the creation of the single currency.

When crises strike a direct blow to governments and to the citizens, the response is rapid, as it was to protect savings and economic activity during the recent bank crisis.

Hesitation is stronger when it is a matter (as it is today) of responding to a crisis raging in some of the euro zone countries, even if that crisis may endanger the Economic and Monetary Union, not to say the very conception we have of the single currency.

We began to experience the bank crisis in 2007, and it only intensified in 2008.

In response to the crisis, a majority of European Union Member states did not wait long to mobilise resources incomparably more substantive than what is being discussed today, when it is a matter of aiding a few Member states in difficulty.

I have made this comparison on more than one occasion: when people talk about doubling the European Financial Stability Facility's lending capacity, for a country such as Belgium that means the guarantee of an additional 15 billion euro to cover the euro zone risks as a whole. We would have to grant a guarantee worth 30 billion all told. I realise that in some countries this doubling is especially sensitive. But on the other hand, when we had to respond to the banks' problems, a 90 billion euro guarantee proved to be necessary for a single bank in Belgium alone! And it was cobbled together in the space of a single weekend without too much humming and ahhing.

The basic difference is that we were dealing with savers, with customers and with businesses that were very obviously located inside the country, and that does not have the same impact as when one casts one gaze with a certain detachment on peripheral countries affected by a sovereign debt crisis.

So, given that this crisis does not spark the same kind of response at the national level, it is crucial for us to hold a fully-fledged debate on it at the European level.

Most of the solutions currently being discussed already exist at the global level, particularly through the International Monetary Fund's mechanisms for intervention. At the start of the crisis, the Europeans did not want the IMF to intervene in its management. In my view, that was a fundamental error. The European countries are stakeholders on the IMF's board, they play a very substantial financial role in it, and the IMF's expertise in accompanying reform agendas is universally acknowledged. Yet it took several meetings for the euro zone simply to accept that, while it maintained leadership, it should nevertheless avail itself of the IMF's expertise.

The method and timing of the intervention are revealing; it is in Europe that people have waited for the crisis to deteriorate in order to suggest that it might be a good idea to intervene. Indeed so much so, that governments avoid seeking this aid through fear of appearing guilty of relinquishing their sovereignty. I hope that one day, possibly with the definitive Mechanism, we will be able to admit that it is aid, and that it is therefore better to intervene as soon as possible in order to allow public finance consolidation programs to be put in place. That obviously requires a certain amount of political courage at the national level. And this European conviction must have a certain durability.

There are two things that I find particularly striking in this crisis that we are experiencing and in the responses that we are devising for it: the smaller the size of the country involved, the stronger the will to act; and we seem to be more than willing to adopt constraining measures, including sanction, in such cases.

Having been a member of the Eurogroup for several years, I remember the situation in 2004, when the two countries that are most willing today voiced the strong hope that there would be greater flexibility in the application of the Stability and Growth Pact (SGP). Thus, after being very firm towards Portugal, which was already an issue then (history has a way of repeating itself), we had to impart a little flexibility to the SGP.

The future is going to demand permanent support for the reforms that we are currently debating.

I subscribe to the contention that this is a year in which important reforms are going to be adopted. Under the Belgian duty presidency, we had to get the European Parliament and Council to approve certain documents concerning European financial supervision. I am happy to see that, in the context of economic governance, ambitious decisions are being taken and I hope that by the end of the year (and I am being prudent here) we will have made a certain amount of progress. But in my view, it is more important that we truly implement what is being debated here today, and that implementation be a long-term affair.

It is important to stress the implementation aspect. Who is going to be in charge? I think that there is a trend, of which I am in favour, towards giving greater powers to the European structures, and that includes the Commission. It is a lengthy business assigning greater areas of authority and tools for action to the Commission, but also to Eurostat in order to ensure that we can work on reliable, shared data.

When I attend European meetings, I invariably notice that political decision-making today is first and foremost intergovernmental far more than it is either European or Community-based. It is a debate that groups the various European countries around the negotiating table, also incidentally leaving the European Parliament on the sidelines for the time being. All decisions are reached in a process that involves the Eurogroup, and possibly also Ecofin, or the European Council or Eurogroup at head of state or government level.

If our aim is to strengthen economic governance within the euro zone, there are several stages we need to address.

The first is that up until now we have always addressed the issue in terms of budget, of figures: the deficit and the debt. We obviously have to continue to pursue public debt and deficit reduction. Allow me, as the minister of a given state, to remind you that it is possible to cut the public debt. We often think of Belgium as a heavily indebted state. Over a decade ago the gap between the Belgian debt and the average euro zone debt stood at 70 percentage points of GDP; today it stands at less than 15 percentage points. I realize that we have covered a large part of the ground in Belgium by cutting our debt, but I also have to thank those who have moved in the opposite direction, thus allowing us to move closer to the average figure…

So it is possible to structurally cut a country's public debt, just as it is possible also to push it in an upward direction. This means that we have to be constantly on our guard over debt and deficit. That must be our priority in the coming months and years.

But an issue that has finally made it into the debate today is the quality of public finances: above and beyond the actual figures, does a balanced budget, or even a budget with a surplus, and with a tiny or virtually nonexistent debt, permit expenditure in the pension field in the years or decades to come, does it allow us to cover other needs linked to an ageing population, especially in the sphere of health, does it allow a sufficient margin for manoeuvre in public and private spending on research, and does it provide an adequate response in the field of education? This means that as individual countries we have to accept comparison with the European member states as a whole, not only in connection with our debt or deficit figures but also in terms of the performance of a certain number of policies implemented. To give you another Belgian example, we, just like every other OECD member state, receive analyses regarding different areas including education, the PISA study. When the analysis is unfavourable, which is sometimes the case in our country, we spend a great deal more time mobilising our universities to explain that the methodology of the study is wrong, rather than trying to discover whether there may indeed be some lessons to be learnt in connection with the quality of our teaching. It may sound like a caricature, but it is in fact the debate in which a number of people get bogged down both in my own country and elsewhere in Europe too.

When we want to debate these different issues, I think that alongside today's finance ministers meetings, there should perhaps be a functioning euro zone rationale also in connection with other issues. Why should employment ministers, social affairs ministers, education ministers, or ministers in other important areas for convergence not hold meetings as well? It would be a start. One way of allowing the euro zone to develop would be for us to hold debates not only on purely economic, financial and monetary issues but also in other areas.

In the context of the Belgian duty presidency in the second half of 2010, the Ecofin Council approved three reports relating to the quality of public finance designed to compare member countries' performance in the fields of health, higher education and pension funding.

I think it is an excellent thing that heads of state or government should meet at the euro zone level from time to time, but why should we not envisage other Council groupings as well, if we wish to strengthen convergence?

I remain convinced that we will not be able to avoid a debate on the political structure of the euro zone and of the European Union.

All of the countries, except for those that have deliberately chosen to opt out, have a calling to eventually join the euro zone; but what political structure makes the decision? Is it exclusively an intergovernmental structure akin to the Eurogroup, which then attempts to push its decisions through the structures envisioned in the treaties? Or are we heading towards an adaptation of the treaties and towards a real capacity for decision-making on a European scale?

Political Europe, the political Union, will not be able to stay out of the debate on economic integration forever.

Every time an important decision has to be reached, which is almost every month, we in the Eurogroup worry about whether or not it will be approved in each one of the member states; and this, not in connection with any medium- or long-term economic vision, nor yet in connection with any medium- or long-term political vision, but in connection with whatever regional or national elections are about to be held in each of the member states.

We cannot carry on living like that indefinitely.

What is the solution for a political union?

I remain convinced that it is going to be necessary to get other groups to adopt the Eurogroup rationale, but the main question is this: what are the most important elections going to be in Europe in the future? Are the most important elections going to continue to be national elections in most of the member states, or is a European election in some form or another really going to become the key moment of choice and of political direction? Today I tend to argue that, other than in the minds of a few European commissioners and parliamentarians, the European legislature has virtually no impact. The thing that has a crucial impact in most member states is still the national electoral timetable.

Perhaps it is going to take another, additional crisis to prompt an acceleration in this process.

What I fear today is that, even if this year is going to be very intense in terms of reforms adopted, I am not sure, unless the crisis hits us again, that it will be followed by one of two equally intense years in terms of the implementation of those reforms.

Implementation always requires a certain amount of time and it is always linked to, and influenced by, debates that are far more of a national than a European affair.

How are we going to resolve this problem?

I know that we are very reluctant to return to the issue of a debate on the treaties, but despite that, I am always rather shocked to note the gap between the highly intergovernmental functioning of the decision-making process and the current debate that we are having on our Europe, which is basically made up of representatives of each of the governments, without any strong Community sensitivity.

I am convinced of the need to rapidly approve the texts, to adopt them, but where their implementation is concerned, I am convinced that the transition to a more highly integrated form of political union (I refrain from using the word “federalism” in order to avoid offending anyone’s sensibilities...) is a necessary transition phase if we wish to provide a more ambitious response.

This integration does not prevent the maintenance of strong areas of authority at the national level, or even of allotting some areas of authority to an even lower level.

Globalisation and more advanced European integration are perfectly capable of being anchored in, and of walking hand in hand with, strong local and regional roots.

CONCLUSION

Conclusion

Etienne Davignon

It would be of course totally impossible, or downright dishonest, to attempt to draw conclusions from this seminar, but I think that it may be worthwhile reviewing a certain number of striking elements, all of which tally with the various different axes of Tommaso's thinking. How should we set short-term benefits against long-term objectives? What can we really achieve, and what should we bear in mind for the future given that we progress from stage to stage? What stages would be dangerous on the grounds that they might jeopardize future stages? I think that the whole debate we have been having revolves around finding a way of reconciling the need to act, an understanding of the situation we are in now, and the definition of future paths that are both realistic and useful.

The first point which I believe to be important and which, in my view, is an initial factor for permanent regret is that the crisis in which we have ended up has eclipsed the success of the ten years that went before it. I think that it is extremely sad because, while it is not a matter of blowing the trumpet in self-congratulation, we should still be aware of the fact that, as Jean-Claude Trichet put it so aptly, we have achieved something that no one else in the world had ever achieved before. We have forged a monetary union without a political union; we have invented a system where ground rules have replaced the legitimacy of the political state; we have set up a payment system that has turned Europe into the largest capital market; we have had ten years of unprecedented stability; and we have created 14 million jobs. No one remembers that. I do not know if you have noticed, but when you are successful and things go right, it is because you are lucky; but when things go wrong, it is your fault. Sometimes, even when things go right, it is your fault!

The second element is that, because we have been too busy pondering our own woes, we have failed to notice that the crisis we have stumbled into is a crisis that has hit all of the industrially advanced countries. There is not a single industrially advanced country that has not met with the same fate; we are not the only ones to be in particular difficulty. Moreover, we have averted the "great depression" that we were justified in fearing. But a word of warning! When we envisage the future, we should not think that everyone hopes that we are going to be successful. I believe that that is an important point. We should be aware that, when the single currency idea was first hatched, a large number of theoreticians explained that it would be impossible. They have been wrong for ten years, but now they think that ten years later they can prove they were right. Not everyone is happy with the fact that there is a strong currency capable of carving out a new place for itself in the global system.

The way in which we show we believe in the decisions we take is a key issue. If we give people the impression that we do not believe in our own decisions, then why on earth should others believe in them? I would like to underline the extremely vigorous defence put up by Jean-Claude Trichet, based on the argument that if one adopts aid mechanisms, one must not also have predicted what is going to happen if they fail, at the same time. I believe that this is a matter of basic common sense. Events will follow their own course. If from the start – swayed by exasperated public opinion – we say those whom we consider to have caused the crisis must not benefit from solutions to the crisis, in the end, their rescue will cost us even more.

So, yes, we have averted the worst. But at what price? The price was realising that upstream we failed to take the decisions we should have taken in order to prevent something that was perfectly predictable. Once again, as Tommaso said, prosperity dims people's eyesight, while crises force them to open their eyes – so let us open them! If we do that, what do we see? We see that we paid the price at a later date for the weakness that we tolerated back in 2004 in allowing the tool underpinning stability to be blunted. But it serves no purpose to go on complaining about that situation for the next few hundred years! What can we do to make sure that such a situation never occurs again? Mario Monti, Jean Pisani-Ferry and Didier Reynders have all pointed in turn to the crucial factors pertaining to the coverage and organisation of governance. So, when all is said and done, what is the most difficult issue? Well, the most difficult issue is finding out what it is that steers European policy. Is it the requirements of European policy, or is it what the individual nation states consider to be acceptable on the basis of their own domestic problems? Unfortunately, we have no choice today but to point to the latter alternative. People examine at the European level what they feel to be tolerable at the national level, which means that if the two requirements ever do converge, it is only likely to occur occasionally and by chance.

Why is this? Well, this brings me to the last issue that I would briefly like to address, namely the issue of Europe's belonging to its citizens and to its member states. We have clearly lost an element of belonging, and I am far more concerned over the response of grassroots opinion, over the difference in attitude that young people have today compared to the people of our generation… I became a pro-European fanatic when I was a schoolboy, after hearing Mr. Spaak and Mr. Beyen introduce the European Coal and Steel Community (ECSC). All of a sudden here was a model, here was a vision, here was something in which we could take part. What are we offering young people today? A lot of confusion, a lack of breadth and depth; I think that it is a major problem. The problem of education illuminating our goals, and inescapably… if we want to put it in simple terms, there is no dodging the political goal. It is not a matter of joining the debate on the kind of structure we need. We cannot debate whether the goal can be achieved unless we imbue it with a political dimension. If we have no statistics on budgets, then we have nothing at all; but if all we have are statistics on budgets, then we have no qualitative analysis of what is expected, from the budget or tax measures.

I think that the European Commission has always allowed itself to be used as a scapegoat because it was felt that its political life was less complicated than political life in the individual member states; but there is an unacceptable difference between that and actually altering the truth. This is where we find ourselves facing a contradiction at the grassroots level between surveys telling us that, when respondents are asked the broader question: “Do you think we need less Europe or more Europe?”, over 75% reply “more Europe”, yet when you ask them less generic and more detailed questions, the percentages change completely. This tells me that there is no education. It tells me that there is no definition of the resources required to achieve the objectives that individual countries can no longer achieve. Populism is also a massive display on the people’s part of no-confidence in their leaders. So, as we gradually build these various measures – and it is obvious that we have built a large number of them – can we really not find it in ourselves to make them more understandable to the public at large?

I am emerging from this meeting with the feeling that something is about to happen; that “something” is that we have not sunk into fatalism. It is not certain that we have made all the best decisions in the world, but what is certain is that the only truly federal structure in our Union has done its duty and it has even gone the extra mile: the European Central Bank (ECB) has been a key trump card in ensuring our correct functioning. I believe that the European Parliament’s role is going to be extremely important, for the first time in the history of European construction, because along with the ECB, the European Parliament is the entity closest to the kind of thing we were expecting from the European institutions. And a little pressure has never come amiss in decision-making.

What are the other decisions that we can demonstrate are not likely to boost anxiety, but indeed are likely to foster a little hope for the future? With a purely technical approach, you can always find smart-alec who will tell you that you should have acted differently. I believe that we have reached a crucial moment. I believe that unless we nurture a little dream in the way we address the terribly complex and critical issues that we are called on to handle, then there is definitely an aspect that is missing. Without dreams, there can be no hope.

THE EURO, THE INVESTORS AND THE GOVERNANCE

Seminar in honour of Tommaso PADOA-SCHIOPPA

4 April 2011, Egmont Palace, Brussels

Programme

9am: **Introduction:** Jacques Delors, *Founding President of Notre Europe*

9.30 am: **1st round table:**
Which assessment for the Economic and Monetary Union?

Chair: Jean Boissonnat, *Journalist and economist*
With Peter Bofinger, *Member of the German Council of Economic Experts*
Mario Draghi, *Governor of the Banca d'Italia*
Jean-Claude Trichet, *President of the European Central Bank*

11.30 am: **2nd round table:**
What do investors expect?

Chair: François Lenglet, *Vice-President of "La Tribune"*
With Michel Barnier, *European Commissioner for Internal Market and Services*
Philippe Lagayette, *Vice-Chairman of Barclays Capital Investment Banking France*
Erik Nielsen, *Chief European Economist at Goldman Sachs*

2.30 pm: **3rd round table:**
For a more efficient governance

Chair: Jean-Hervé Lorenzi, *President of Le Cercle des économistes*
With Mario Monti, *President of the Bocconi University*
Jean Pisani-Ferry, *Director of Bruegel*
Didier Reynders, *Deputy Prime Minister and Minister of Finance of Belgium*

4 pm-4.30 pm:
Conclusion: Etienne Davignon, *President of the Egmont Institute*

Legal Mentions

This publication has been realized with the support of :

With the support of the European Commission :
support to active entities at European level in the field of active European citizenship.

Notre Europe also receives the financial support of the French Government, the Compagnia di San Paolo, the Macif and the Grand Duchy of Luxembourg.

Dépôt legal