FROM THE CRISIS TO A EUROPEAN ECONOMIC STRATEGY

A Conversation With Tommaso Padoa-Schioppa

on the Eve of the June 2010 European Council

15 June 2010

1. How would you describe the way the European Union has handled the crisis since the Spring European Council?

The European Union and Greece have every reason to consider the handling of the crisis a great success, an achievement whose relevance goes well beyond what most observers believed possible until then.

The decisions reached in May consist of two groups of actions: the measures to redress the Greek economy and the measures put together by the EU.

The first group of actions, as part of Greece's pledge to the troika (the EU, the ECB and the IMF) in return for financial aid, is an extremely vigorous recovery plan, which looks both strong and very brave by comparison with those that other countries have adopted in similar circumstances. The plan, designed to slash the country's public deficit by 30 billion euros to push it back at 3% of GDP by 2014, was adopted by an absolute majority in the Greek Parliament on 6 May.

The EU's decisions, on the other hand, consist of an aid package for Greece worth 110 billion euros, the approval of a 750 billion euro stabilisation fund and the ECB's decision to buy euro area member countries' bonds if such a move were to become necessary. **These measures go well beyond what the markets considered to be indispensable before the meetings in May. In terms of both quality and quantity, they are unprecedented in EU history.**

People blame the EU for failing to act with sufficient speed and it is true that, if the decisions had been reached two months earlier, the EU would have intervened at a time when the markets were less nervous. But we have to remember that it is in the nature of such extraordinary democratic decisions as these to require a longer gestation period than one would perhaps like. It took time for the EU, and for Greece too, to forge the political will to implement a fully-fledged change of course. Then again, if we compare the time that it took the EU to reach a decision now with the time that it took the United States to reach one in the autumn of 2008 in the wake of the panic triggered by the *Lehman Brothers*' bankruptcy, we shall see that the « Troubled Asset Relief Program » (TARP) was not approved more rapidly, and indeed it even came up against a negative vote in Congress. **Europe is not the only place where the time required to implement a policy decision is longer than the time it takes to merely devise measures.**

2. Despite all the action that has been taken, the markets do not appear to have settled down; does this suggest that what has been done to date is insufficient?

The measures adopted by the EU and by Greece have been followed by bursts of nervousness in the markets, which means we cannot assert that there has been a complete return to normality.

This is due to several factors, in my view.

The first of these is that **the markets and public opinion act the way anyone would after a fit of hysteria: they find it difficult to calm down instantly.** Their nervousness does not just disappear, and it does not take much to stir up their anxiety, their concern or their false hopes again. There is a dynamic regulating the return to normality that itself takes time to kick in.

A second factor is that **the players in this policy, especially on the European side, have occasionally disturbed the markets through inconsistency in communication.** After joint decisions had been reached in Brussels, some then went back home and promptly marked their distance from those selfsame decisions. So the markets began to wonder whether the decisions reached were really irreversible, and to fear that they had not truly been adopted. Thus the European players themselves have to bear some of the blame for the sluggish pace at which confidence and normality are being restored.

A third and deeper cause has cultural roots that can be best explained in the following way. **The force really driving the attacks on the euro is a lack of confidence in the EU's ability to move forward in the historic task assigned to it**, namely setting up a fully-fledged union, building a power designed to complete and to supplement its member states' power (while curbing it at the same time). **When all is said and done, what is at stake in this European**

crisis is not Greece but the euro, and beyond the euro, the Union itself. People have difficulty in grasping the nature of the European project because both market operators and a majority of observers are unwittingly bound to a political model in which all power is held by the nation state, and they think that any other kind of order, such as the one that the European Union is building, is not really feasible. We might call this a Westphalian mindset, going back to the Treaty of Westphalia in 1648 when the end of the Wars of Religion was marked by a treaty recognizing each country's power to choose its religion and its right not to have to put up with any external interference. The majority of today's actors still have a political culture anchored in this model. Now, the European Union is a new historic experience based on building a post-Westphalian order. If we fail to see that, then we will inevitably harbour scepticism and lack confidence in the very existence of such a thing as the Union. So if you are a market operator or a commentator, you naturally tend to put your money on the experiment failing rather than on its being a success.

The decisions reached in May are a success, but the hard kernel of underlying scepticism that I have just described is preventing people from recognizing it as such. The markets and the opinionmakers, be they journalists, commentators, academics or economists, should openly acknowledge the value of the EU's action. We have to be well aware of the fact that such acknowledgment is imperative if we are to see a return to normality.

3. What more needs to be done, in your view? What are the priority areas in which the EU needs to take action?

The European Council will be meeting for the first time since its major decisions in May, and its main task is to take stock of the situation and to debate what comes next. **The decisions reached in May have allowed to play for time, but they have not really addressed the deeper causes of this crisis of confidence.**

It is true that the EU has proven capable of acting in a new and imaginative way, giving the lie to earlier scepticism. Yet we have to recognize that the lack of confidence is still there. How can we remedy this?

The most important thing for Greece is to ensure that it implements the plan it has approved. « Execution is everything », as Napoleon used to say. Neither an act of political will nor approval by the legislative branch are sufficient of themselves; the plan approved has to translate into concrete action on the basis of a tight timetable for implementation.

Where the EU is concerned, the first requirement is to totally eliminate the risk of contagion. This requirement means that the countries which the markets might target or attack - in other words Portugal, Spain, Italy and Ireland - need to take measures to remove the fear of contagion. That process is currently under way but it is not yet complete. The Italian Government has adopted an austerity plan that has won the Union's support, but the Italian Parliament has yet to approve it; on 27 May the Spanish Parliament approved the government's austerity plan, but only by a very narrow margin; and on 2 June the Portuguese Parliament approved the broad outlines of an austerity plan that the government had published in May. These examples tell us that we are on the right track in our endeavour to isolate the case of Greece, but we have not yet travelled the whole path.

The EU's second priority consists in strengthening the discipline of the Stability and Growth Pact in order to correct the errors made in the past in its preventive action.

But all of the things that I have just listed are not yet a full action plan for organizing the European Union in the aftermath of the crisis ; they are only complementary - both for Greece and for the EU - in the handling of that crisis.

What should that plan look like? To draft it correctly, we first need to be aware that **the basic scenario for the Union in the coming years is going to be marked by greater budget austerity and slow growth.** It is easy to see how that is bound to be the case, because given that the markets' principal concern is the state of public finance in certain EU countries, it was impossible to avoid major budget adjustments. Yet at the same time, the markets shifted almost from one day to the next from concern over the state of budgets and public debts to concern over the weaker growth that would result from the very budget adjustments that the markets themselves had demanded. Thus the new wave of concern is that growth will be slow and that the economic, social and political consequences of this will be difficult to bear.

It is with that basic scenario in mind that the European Council is going to have to reflect on its post-crisis agenda. In my view, **that agenda should absolutely include action capable of ensuring that Europe's economy remains dynamic.** There are many items on the European agenda today: the implementation of the Europe 2020 Strategy which the European Council is due to adopt in June; a fresh boost to the Single Market following the report that Mario Monti submitted to the Commission in May; the reform of the EU's budget, a debate on which will be launched by a Communication that the Commission will be publishing in September ; and the economic governance and the report of the group of experts chaired by Van Rompuy, which is due to be submitted in October. These different factors have different origins and uncoordinated procedures. **It is necessary to bring all of these disparate factors together to fuse them into a comprehensive strategy for the European economy over the coming years.**

4. What should this European economic strategy consist in?

The EU member countries need both budget stringency and support for growth at one and the same time. **The key concept should be that the member countries must devote their energies to fiscal consolidation, while the EU must focus on supporting growth. Moreover, the EU should not play the role of a *coordinator* of national policies so much as that of an economic policy *actor* in its own right.**

There can be no question but that it is crucial for the EU today to relaunch and to strengthen its *single market*. Yet we need to be aware of the fact that **a single market is not sufficient.** We also need to develop positive stimulant actions, and those actions should involve **developing policies for which the treaty assigns 'shared responsibility' to the EU and to the member states** (in accordance with Article 4 in the Treaty on the Functioning of the European Union). The policies in question concern in particular the fields of energy, transportation, research and the environment. They have never really been implemented by the EU as a player. People wanted to believe that it was enough just to set up an integrated market (and even that has not been fully accomplished), but a single market is not sufficient in those fields. In addition to legislative and regulatory action - which helps to create the single market - it is necessary for the EU to be able to act in its own right, and it can only act by mobilizing resources for its action. Thus what the EU needs to put in place is a program of European investment or public spending. **In order to do that, the EU needs a more flexible budget with resources coming directly from the taxpayer, and it needs to use its borrowing capability.**

In this context we should highlight the greater effectiveness of European public spending over national public spending. It is easy to demonstrate that, without altering the overall amount of (national and European) public expenditure, if we were to cut back on the national part and to raise the European part by the same amount, that would allow us to achieve better results, or to achieve the same results while spending less.

It is also important to stress that the money which goes to make ups the EU budget must not come from member states' budgets the way it does today. The EU must have the ability to mobilize taxpayer resources directly, through one or two European taxes that would move money straight from the taxpayer's pocket into the EU's own coffers. The member states have arranged for their national budgets to act as filter between taxpayer resources and the EU in order to allow them to maintain control over the EU's resources. The effect of this filter function is that member states perceive the resources allocated to the Community budget as being funds of which their own national budgets have been deprived. That is a mistake; there is no federation in the world in which federal taxes go through the states (the United States), the provinces (Canada) or the *Länder* (Germany) the way they do in the EU. If we had the European carbon tax or the tax on financial institutions that people are currently talking about, there is no reason for those taxes - which, incidentally, European grassroots opinion would have no trouble in understanding - to go first to national budgets before being transferred from those national budgets to the EU.

I am very well aware of the fact that what I am proposing here may sound very ambitious, not to say utopian; yet I believe that **continuing to pursue a concept of economic governance consisting in assigning the EU a role as the coordinator of national policies is an even greater utopia than that of building a modest EU ability to act as a player in its own right.**

Once again, in the federal states that we know today, federal government has no powers of coordination and the members of those federations would not tolerate being coordinated by the federal government. If President Obama made the suggestion that the federal government coordinate the actions of the individual state governors, he would have a rebellion on his hands. People in Europe consider it excessively ambitious for the EU to develop its capacity to act in its own right, yet at the same time they are pursuing the even less realistic dream of coordinating the member states' actions.