Tommaso Padoa-Schioppa is President of *Notre Europe* and Chairman of Promontory Europe. He is Chairman of the Trustees of the IFRS foundation & International Financial Reporting Standards. He was Italian Minister of Economy and Finance (2006-08) and Chairman of the Ministerial Committee of the International Monetary Fund (IMFC, 2007-2008). In 1998-2005 he was member of the first Executive Board of the European Central Bank. Previously he was Chairman of Commissione Nazionale per le Società e la Borsa (CONSOB, 1997-98), Deputy Director General of the Banca d'Italia (1984-97) and Director General for Economic and Financial Affairs at the Commission of the European Communities (1979-83). He has been Joint Secretary to the Delors Committee (1988-89), Chairman of the Banking Advisory Committee of the EC (1988-91) , Chairman of the Basle Committee on Banking Supervision (1993-97) and Chairman of the Committee on Payment and Settlement Systems (2000-05). He graduated from the Luigi Bocconi University and has a M.Sc. from the Massachusetts Institute of Technology.

« Stability, Yes; but also Growth »

A Conversation with Tommaso Padoa-Schioppa

on the Eve of the October 2010 European Council

Tommaso Padoa-Schioppa
October 2010

1. Where do we stand on the eve of the October European Council?

2010 is the year in which the crisis has come to Europe. This happened not because the causes of it were primarily European: on the contrary, Europe did not have big external imbalances, did not have a lack of domestic savings and had less extreme forms of speculative finance. It became European because, at a certain point in time, markets started to perceive that Europe lacked the instruments to manage it; that the Union, in a way, was not a union. Hence a collapse of confidence in the Economic and Monetary Union's capacity to survive the storm. The immediate targets of speculation were the solvency of some member countries and the ability of some sovereign debtors to sustain themselves, but the ultimate target was the Union itself.

2010 is thus the year in which the EU and the EMU are called to contradict this sentiment and restore confidence by showing ability to act as a Union in front of a major challenge threatening its survival.

In my June conversation I observed that, with its May-June decisions, the EU acted forcefully against the crisis: in May, by obtaining from Greece a serious adjustment package, by offering a very substantial financial support to Greece and by creating new instruments such as the European Financial Stability Fund; in June, by agreeing on a program of fiscal consolidation for all the member countries. These decisions refuted the critics of EU impotence. Yet, they were just emergency actions to stop the loss of confidence, not structural measures improving the crisis management and the crisis prevention ability of the EMU in a permanent way.

So, the risks are still there and the challenge is to move from emergency to structural corrections. The yardstick against which the Council's deliberations will have to be judged is the needed structural reforms in the EU economic policy framework as compared to the emergency mechanisms of May-June.

2. Given that, how to assess the desirable outcome of the October European Council?

The European Council will have on its table the Commission's proposals for reforming the EU economic governance framework and the Van Rompuy's Task force final report. At the same time, there is the Franco-German position expressed in the Deauville Declaration of October 18. The question is: given these inputs, what could be the output? In other words, what ought to be the conclusions of the Council?

My sense is the following: if the Heads of State or Government decided to adopt in full the proposals embodied in these various inputs the EU would, first, make a significant step forward in increasing fiscal discipline; second, lay the foundations for a possible surveillance mechanism on external imbalances among member countries; third, progress towards the creation of permanent mechanisms for crisis management and resolution; forth, and finally, move to create the legal and institutional instruments to implement the above.

Let me elaborate on these various points. As to fiscal discipline, there is a clear tightening of the pre-crisis prevention and sanctioning apparatus, although not as pronounced as in the Commission's proposal. On the macro–economic front, there is the important innovation that not only fiscal but also external imbalances will be subject to a common discipline, and this will concern not only deficit countries but also surplus countries. On crisis management and crisis resolution (the third point), if the Deauville declaration becomes reality by making the European Financial Stability Fund permanent and creating a crisis resolution system which also foresees some burden sharing by private creditors, an important gap of the Maastricht constitution would be filled. Finally, on the fourth point, there is an acceptance (again in the Deauville declaration) that Treaties will be amended to make all these reforms possible.

All these are positive steps. Yet, two big questions remain to be answered: would these points really be implemented in the way I describe them? And, if so, will they be sufficient?

3. Take the second of these questions; do you think these reforms would be sufficient?

No, I think they are not sufficient. Indeed, two elements are missing.

First, we are still predominantly – although, admittedly, not exclusively - in a logic in which the EU is a *coordinator* of national policies rather than an *actor* for itself. It is a coordinator of fiscal policies and of policies related to competitiveness and external imbalances, but it does not really have instruments of its own for the conduct of an EU policy. We have to convince ourselves that a European economic governance which assigns to the EU a mere role of coordinator is both too weak and too ambitious. Too weak because it is fatally flawed by the fact that the power of coordinating is at the hands of the same ones that are supposed to be submitted to this power. And too ambitious because it grants the EU a power of intrusion in its members States policies that - even in mature federations - the central government normally lacks vis-à-vis local governments (be they States, Länders, Provinces or Regions).

So far, this limitation is surmounted only by the proposal to make the Financial Stability Fund a permanent mechanism. And even there, however, one should note that the wording of the Deauville declaration is very ambiguous, because it talks about "allowing member states to take

appropriate coordinated measures to safeguard financial stability of the Euro area as a whole". This sentence does not seem to confer to the EU an instrument, but only a coordination task.

The second reason why the proposed reforms are not sufficient is that they provide only a *stability* framework, not yet a *growth* framework. Fiscal discipline by itself will not suffice to put the EU on a sustainable path, such that it limits unemployment and improves fiscal ratios. The Irish case is a blatant demonstration of this: Ireland did approve very rigorous fiscal adjustment measures, but these have depressed the economy so much that fiscal ratios deteriorated instead of improving.

Thus, fiscal austerity alone will not give Europe sufficient growth to preserve it from the risks of higher unemployment, lack of political consensus and social tensions. The social and political risk, in particular, is very high, as illustrated by the rise of xenophobic and populist movements across Europe and by recent demonstrations in Paris, Brussels and other member states. These are not simply risks hitting individual countries; they may jeopardize the cohesion and survival of the Union itself as well as democracy on the continent.

The scheme of the last years – in which stability came from Brussels and growth from member States - has now to be reversed. In our days, stabilization policies are imposed by market pressures that national policymakers cannot ignore. In these circumstances, a coalition of Member States to make the EU itself the engine of growth is the only way – and a politically rewarding one – to rebalance overall economic policy and avert a depression.

To sum up, the European Council is confronted with reform proposals which are necessary, but not sufficient. Moreover, it is far from granted that even the necessary part (namely the 'stability' reforms), will be implemented in a forceful way. I repeat, the initial proposals of the Commission have been weakened, by giving more power to the Council and less to the Commission, with the result that discipline is still largely based on the hope that the 'peer pressure' game will become more effective. We have, unfortunately, reasons to doubt that this will happen.

4. You deplore that the EU is not an economic policy actor. How could we remedy this?

Various steps can endow the EU - or at least the Euro area - with own instruments, thus converting it into a real policy actor.

One is the activation of the European Financial Stability Fund. The Deauville declaration states this intention, but there are no indications yet as whether the Fund will be used as an active instrument or simply as a reactive instrument for a rescue in a crisis situation.

Notre Europe raised this point in a recent Financial Times's article, co-signed by Peter Bofinger, Henrik Enderlein, André Sapir and myself[1]. We highlighted the need to mobilize the Fund to support countries with high fiscal and current account deficits in their painful adjustment processes. I welcome the fact that our idea to make the Fund permanent is now supported, but the second proposal - to activate its resources to support growth in economies which are seriously adjusting – is not yet supported.

Beyond this, the current EU agenda already comprises most of the items that are needed to make the EU a growth promoter: strengthening and re-launching the Internal Market, as the Monti Report suggests, effectively implementing the 2020 strategy, reforming the EU budget, issuing Eurobonds to finance investments in infrastructure. Such items should now be unified to become the chapters of a true EU Program for Growth. This can only be done by the European Council itself in what I would call a 'top down' mode, in which the political leaders give directions to the bureaucracies; indeed, we cannot expect the impulse to come from the officials.

As part of this program, the EU should be entitled to raise revenues directly from the taxpayer. The creation of one or two EU taxes would provide enormous advantages: it would not only produce revenue necessary for financing growth-enhancing measures, but its introduction would have in itself positive incentive effect. For example, a tax on financial transactions or on banks could serve to contrasting excesses in finance, and an EU carbon tax would contrast climate deterioration.

5. How does the EU debate fit in the global G-20 debate on the eve of the Seoul Summit?

Among the advanced economies there is a growing divide between the EU and the US. Europeans are much keener to restore monetary and fiscal discipline, fearing that injecting macro-economic stimulus by increasing liquidity and deficits would further destabilize the economy, whereas Americans seem to be less concerned by the longer-term risk of delaying an exit from stimulus policies. This may create a conflict, which initially concerns exchange rates, but overtime could lead to tensions in the trade sector.

This situation is aggravated by the fact that the exchange rate debate also involves emerging economies, which resist the pressure to accept an appreciation of their currencies. In recent weeks, the debate on exchange rate has become the epicenter of international tensions. One can say that the crisis originated as a sub-prime crisis, in which certain toxic assets

1 « Euro-zone needs a permanent bail-out fund", Financial Times, September 27 2010

were targeted by the market; then financial institutions were targeted, then sovereign debt was targeted, and now it is the turn of currencies.

All this tells us that it is urgent to reform the international monetary system, and I welcome the decision that this will be a main item of the G20 agenda in 2011. A global monetary m is particularly important for Europe because, while having the best currency and the most balanced monetary policy, Europe may be the main victim of a spiral of competitive devaluations, in which all currencies want to depreciate and the Euro remains as the only one that keeps appreciating.

With the Support of the European Commission

Education and Culture DG

'Europe for Citizens' Programme