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Conference

«EMU Governance and Euro Changeover: Slovenia on
the path to the adoption of the euro»

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Keynote

EMU Governance

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EMU GOVERNANCE

Distinguished guests,

In political terms, the European Union is a success having managed to expand to 25 member states and 455 million citizens through a series of enlargements. In economic terms, step by step, economic integration has progressed from a free trade area to the biggest internal market in the world. The internal market was boosted by the Acte unique signed in 1985 and was supplemented by Monetary Union as decided by the Maastricht Treaty adopted in 1992. These few dates help to remind us that European integration is a long term process.

One of the reasons for economic integration and monetary Union was to help achieve higher growth rates. In this respect, the assessment is gloomy. Actually the EU has achieved rather poor economic performances. Notably in recent years, while world economic activity has expanded at high rates, the EU has been lagging behind, not to mention the Euro-zone. As a result, the level of unemployment has remained constantly above 8 %.

The rejection of the constitutional treaty by two of the founding countries of the EU can be partly attributed to these poor economic performances while the EU had been sold to the people as a means to reach higher growth. These promises have clearly not been fulfilled. Why? Part of the

reason lies in the poor governance of the EMU which makes it difficult to deliver its promises.

As originally devised, the EMU is still a framework lacking balance

The EMU explicitly covers two dimensions, the economic dimension and the monetary one. The latter is the best defined since there is one single monetary policy embodied in one institution, the ECB. The former one, the economic dimension, does not provide the same clarity in terms of scope and institutional arrangements: it is underpinned by an internal market without barriers for goods, services, capital and labour and it takes the form of an EU economic policy which is two-fold in theory: coordination of economic and fiscal policies amongst Member States under the constraint of the Stability and Growth Pact, and structural long-term policies as set in the Lisbon strategy.

The bright side of EMU is that the internal market, coupled with the single monetary policy, has fostered trade, travel, integration and EMU has delivered currency stability to participating countries with a low inflation environment coupled with increased transparency. To be honest, this result has to be mitigated by the fact that price stability happens to be a general feature in today's world economy and low growth in the Euro zone has helped to achieve this low level of inflation. Internationally the Euro zone is better protected against external shocks and the Euro has established itself as a credible alternative currency to the US dollar, notably as a reserve asset. This bright side of the EMU is somehow counterbalanced by the fact that EMU's stability has not engendered economic growth. EMU has meant that the EU's economic policy

structures have matured, but we must do more to ensure they also deliver growth to the EU economy.

In any case, what we are aiming for in Europe is a more adequate balance between stability and growth. I will just mention that the disconnection between monetary policy and economic policy was originally implied in the epithet "Economic and Monetary Union", since it inferred that monetary policy was distinct from the economic policy, though you may also argue it is one element of the economic policy. So this defect was originally built into the original construction the driver of which was more a political one than an economic one. The issue now is how to fix this defect. It is all the more necessary now that a monetary union is dependent on the strength of the political union which underpins it and that in the absence of further advances in political union, a risk of dilution or fragmentation of the EMU cannot be ruled out.

Firstly there is a need for better coordination of national fiscal policies

The challenge lies in the fact that the member states of the EMU have renounced national monetary policies for a single monetary policy whereas they have retained full responsibility for the budgetary policy. The coordination of the fiscal policies has not taken place so far and anti cooperative policies have even occurred. The SGP is not such a hard constraint as was the exchange rate risk before the EMU, with the risk of devaluation or revaluation and it has proved largely ineffective. Large countries like Germany and France, where social consensus to implement structural reforms is harder to find, have been affected more sharply.

Some small countries which are by nature more open to trade have used social and fiscal dumping. The Netherlands, which once criticised Germany for not fulfilling the SGP, are now suffering from the recessive policy pursued in Germany through the reduction in exports to Germany. Divergences in the Euro-zone economies with countries for which growth is mainly based on exports (Germany, Austria) and countries for which growth is mainly based on internal demand (France, Spain) are a proof of the lack of coordination and result in antagonistic effects which cancel each other out.

In the absence of exchange rate adjustments, a lack of collective agreement is detrimental for every member state, at some time or another, and this lack contributes to reducing EU growth. The current coordinating tools are still not enough. For instance, the Broad Economic Policy Guidelines have no real impact on the definition of national fiscal policies. Coordination would infer that governments share the same assessment of the economic situation and define common priorities and investment strategies. Due to the diversity of governments within the Eurogroup, it is hard to achieve. In practice, the coordination has taken the form of peer pressure on an ex post basis. There is so far no ex ante coordination in a situation where oil prices are rising, whereas coordination of economic policies in case of a common external shock is best suited. The SGP is only an ex post constraint, which does not deliver enough: since 2003 eleven of the EU 25 member states have deficits exceeding 3% of GDP among which the four largest economies, France, Germany, Italy and the UK.

Some progress has been achieved in coordination. The reinforcement of the Eurogroup through a stable presidency was an important step forward

and the pragmatic action of Jean Claude Juncker as head of the Eurogroup is to be praised. For instance promoting budgetary coordination using same macroeconomic data and converging budgetary schedules is indeed useful. The involvement of national parliaments in this process might also help and this is why as chairwoman of the ECON I have taken since 2 years the initiative to invite representatives of national Parliaments as well as Commissioner Joaquin Almunia and Jean-Claude Trichet to discuss together the priorities and the way of implementing them before we give our opinion on the Broad Economic Policy Guidelines. The SGP has been reformed in 2005 by the reinforcement of its preventive arms and the softening of the corrective arm. Even though, I still believe much more can and should be done.

Secondly there is a need for better coordination between fiscal policies and the monetary policy

In addition to the insufficient coordination of national economic policies, the inadequate policy mix in the Euro-zone is also due to the overcautious attitude of the ECB which led to an asymmetric monetary policy: the ECB is quick to raise interest rates when risks for increased prices are looming and slow to reduce interest rates when there is no inflation risk and poor growth forecasts. Everybody accepts the need for price stability as a precondition for a healthy economy, and there is also a consensus on the idea that an independent authority can deliver it most efficiently even if these days we can observe in a member state rather worrying discussion going on. But a central bank should also contribute to economic growth and employment, especially if price stability has been achieved. More specifically the EU Treaty in its article 105 says that the ECB is obliged

to support the economic policies of the EU having achieved price stability. Several central banks in the world in practice pay attention not only to price stability but also both output and employment, such as the US Federal Reserve. The truth is there is no similar situation in the world in terms of independence as the one experienced by the ECB. The status of the US Fed is much different since the institution before which it is accountable is also the institution which confirms its nomination and can modify its status. Moreover there are still progress to be made concerning the transparency of the ECB which by not publishing its minutes prevents a debate from developing which could help define coordination between the fiscal policies and the monetary policy. The strong degree of independence of the ECB calls for a clear democratic counterweight.

A policy which is simply orientated towards price stability and institutional arrangements have neutralised monetary policy, which is detrimental to growth in the Euro-zone. No real pro-active relationship between the Eurogroup and the ECB has still taken place. The reasons put forward by the ECB for explaining slow growth is the lack of structural reforms. But comparisons show us that countries which have managed to reform their economy such as Canada and Sweden have been helped by a more dynamic monetary policy and higher growth to facilitate these structural reforms. By contrast with the lack of active monetary policy and budgetary policies in the Euro-zone, I would also recall that the US policy mix is much more active and the US Federal Reserve is praised and respected for its balanced action.

Thirdly the external representation of the Euro-zone has to be strengthened

In terms of external representation of the Euro-zone, there is room for improvement. The Euro has experienced tremendous growth in international markets since its creation. It is now the second world currency. The challenge is to achieve a better representation of the Euro-zone to gain European influence based on its acquired credibility. Notably it is not clear which institution is responsible in terms of representation of the Euro, which could be dramatic in view of the risks of rapid adjustments of the global imbalances that could result in changes in the Euro exchange rate against the US dollar with direct impact on growth. A better representation of the Euro-zone in international institutions is needed. Specifically the European Parliament calls for a single European seat at the IMF Board as required in a resolution voted three days ago.

How can we achieve a better governance of the EMU? How can institutional arrangements help?

Some institutional changes are necessary to revamp effectively the EMU framework. Apart from the Eurogroup, which is an informal structure, a specific representation of the Euro-zone would contribute to strengthening it as the core of the EU. Before the enlargement, the Eurogroup formed the bulk of the Ecofin Council. Now that it represents 12 countries out of 25 some specific mechanisms have to be devised to strengthen the core of the EU. Some impulse could be given by a European Council specific to Euro-zone member states which would devise better coordination mechanisms. There is a need to think out of the box on convergence of tax and fiscal policies, wages, minimum wage ...

Whereas the spirit of coordination matters and has to be developed, the institutional framework has also to be reinforced.

Better involvement of the national Parliaments can help internalise the need for European coordination. This is the reason why annual meetings with national parliaments are organised under the aegis of the Economic and Monetary Affairs Committee of the European Parliament. The accountability of the ECB has to come true, notably through a more democratic process of nomination of its executive board members and the provisions for revision of its statutes. There is also a need to give a face to the representation of the Euro, for instance a Commission vice-president could play this role.

The sustainability of EMU is at stake if there is no revamping of its governance in order to deliver higher growth and employment. The positive side is that in common with other phases of the European construction, there will be a degree of learning-by-doing. We have learnt that the EMU as originally built does not work as it should, which will bring about pressure for adjustments. Let me conclude this speech by underlying how much the discussion around any enlargement of the Eurozone reinforce, if ever it was needed, the pressure to make sure we get the best evolution we can.