

Καλό σε όχθου με χερσού  
του Ευρωπαϊκού Διαδερότητος  
και των εργασιών άτατο.

Τροπάσεις του μεσσηνίου  
ωρύνωσθιόμο.

Η ταυ άστωσθιόμο οτι θα άσπιδί  
τη χώρα. Είναι ωρύνωσθιόμο οτι η χώρα  
θα είναι ερωσθιόμο.

Θά έρωσθιόμο να άσπιδί του Αρι-  
ωσθιόμο και του Ε.Ε. άσπιδί  
τησθιόμο του άσπιδί άσπιδί  
άσπιδί άσπιδί άσπιδί άσπιδί  
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## Economic governance in a European Union of 25 Member States

Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

Conference on EMU and economic governance

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Ladies and Gentlemen,

I would like first of all to thank my gratitude to all the distinguished participants of the panel and the audience for participating to what, I think, will be a useful contribution to the on-going debate.

Five years since the birth of our single currency and seven years since the creation of the Stability and Growth Pact (SGP), we can make an overall positive assessment on the functioning of Economic and Monetary Union. In spite of recent difficulties, there has been no return to the profligate budget policies of the past. The Stability and Growth Pact and multilateral surveillance have played a decisive, albeit sometimes difficult, role in containing the deficit levels during the economic slowdown. Overall the ground has been created for more sustainable public finances in the future, which are an important condition for a strong and long-lasting economic performance of the Union.

However, while the overall judgement is positive, it is fair to say, that we also had our fair share of problems. The application of the framework can be improved, to deal with some weaknesses in its implementation or, possible, in its design. Among the areas where, in the Commission's view, improvement is needed, I would like to mention the following:

Firstly, the EU coordination framework has been perceived as focusing mainly on fiscal policy, and in particular on budgetary balances and fiscal discipline, rather than on the overall interaction of various policies. This has however been changed de facto with the emergence of the Lisbon agenda, which put quality of public finances in the forefront of the economic coordination debate. It is therefore clear that efforts need to be made to better interlink economic and budgetary policies. In our view this requires an "upgrading" of the Broad Economic Policy Guidelines (BEPGs) as the instrument of choice for the coordination of economic policies and a better coordination of the BEPGs with the budgetary coordination carried out through the Stability and Growth Pact (SGP).

Second, the rules which apply to budgetary policy coordination have on some occasions shown their shortcomings. It is for example widely recognised that the framework is lacking adequate incentives for prudent behaviour during the good times of the economic cycle. The EU framework needs to evolve to better take into account the changing economic and budgetary circumstances within the EU. Enlargement has increased the economic diversity of the Union and this has implications for our economic governance.

It is true that the Commission has over the last few years improved the implementation of the Pact by applying economic rationale to the interpretation of its rules. I believe however that this approach cannot be pushed any further unilaterally by the Commission without losing credibility and without putting the rules-based system at risk. We need therefore to strengthen the implementation and improve the interpretation of the Stability and Growth Pact together with the member states through a credible process. We need to create political consensus around an improved implementation, a consensus that will outlive the test of time.

Thirdly, the enforcement by the member states of the provisions concerning both the prevention and the correction of unsound policies has not always been sufficiently reliable. Thus, the implementation of the fiscal framework has not been always consistent with the ambition of the Treaty and the Stability and Growth Pact.

To a certain extent, this has led to a loss of credibility and ownership and even to institutional uncertainty at the European level.

Let me now share with you my main considerations on how, I believe, economic governance could be strengthened. To start with, I would like to stress that the two nominal anchors of the Treaty – the 3% reference value for the deficit to GDP ratio and the 60% for the debt to GDP ratio – have proven their value and we will continue to remain at the centre of multilateral fiscal surveillance.

Looking forward, the first step would be to increase the focus on debt and sustainability in the surveillance of budgetary position, aims at strengthening the rationale of the framework.

In principle, compliance with the deficit ceiling should implicitly ensure adequate debt reduction and sustainability of budgetary positions. However, in several countries we have experienced a weakening link between the budgetary balances and debt dynamics. Indeed, compliance with the deficit ceiling has at times entailed short-sightedness in the conduct of budgetary policies, including the recourse to one-off measures. Increased focus on debt dynamics, including through more active surveillance of the respect of the debt criterion of the Treaty, would complement continued rigorous attention to deficit developments and should contribute to achieving prudent debt positions over the long term.

Second, the definition of the medium-term objective, a key element of prevention, also needs to be revisited along these lines. Given the increasing economic diversification in a Union of 25 Member States, a uniform specification of the medium-term objective for all countries does no longer appear adequate.

Revisiting the definition of the medium term objective would imply that objectives could differ across countries. Those countries which need to improve the sustainability of public finances need to maintain budget positions close to balance or in surplus for a sustained period, until progress is made on reducing debt levels and, if necessary, implicit liabilities. For countries where current positions and expected economic and budgetary developments imply that sustainability is secured for the future, small deficits could be allowed without jeopardising such prospects. This approach provides a “proxy” to the economic rationale of the so called “golden rule” mentioned so often in the debate.

But it does not entail all its risks, such as accounting problems arising from the definition of which expenditure should be classified as investment, the drift towards high deficits if a large part of the budget is excluded from the surveillance, and the bias towards physical capital which the “golden rule” could induce at the detriment of other forms of productive expenditure.

It needs to be stressed, however, that such approach towards defining the medium term objective should ensure compliance with the 3% reference value under all times and guarantee equal treatment across Member States.

The third element more directly linked to the implementation of the SGP is how to strengthen enforcement. This calls for an improved preventive mechanism. Experience has highlighted the need to conduct prudent and symmetric over-the-cycle policies to avoid running into troubles at a later stage. Incentives to run such policies should be strengthened.

Reinforcing peer pressure, possibly by a more active use of early warnings, is an important option to ensure the appropriate policy action during the good times. On this point, let me be somewhat critical of the behaviour of those Member States which in the past have showed unwillingness to act and follow the Commission's recommendations.

It seems to me evident that all efforts should be made to make peer pressure work, as ultimately is the instrument on which the Treaty mainly relies. We cannot govern EMU with sanctions and threats. We created the single currency through a political process, and we have to manage the euro in a political way, through a strong role of the Council in the surveillance of national budgetary policies.

Clearly, more public debate on budgetary surveillance could also improve the enforcement mechanisms. In this context, greater involvement of national bodies monitoring national budgetary and economic policies and publication of their views in public should be encouraged. In addition, a closer involvement of national parliaments in the co-ordination process could help to bolster accountability at the Member State level and increase the effectiveness of peer pressure.

At the same time, prevention and peer pressure rely on clear and reliable information. Shortcomings in the collection of national statistics in some Member States identified over the last five years, and most recently put in evidence by the revision of the Greek data, must also be addressed. It is of the utmost importance to ensure minimum European standards for the institutional set-up of statistical authorities and we need to accept tougher surveillance mechanisms by Eurostat in this domain. Efficient budgetary and economic surveillance is impossible without reliable statistics.

Before moving to the discussion from the preventive to the corrective measures, let me stress that the ideas indicated above seem to benefit from a large consensus, both in the academic and political spheres. As an example, the Informal ECOFIN meeting of 10-11 September, in its statement on the SGP, supports them explicitly. Let me quote: 'In strengthening and clarifying the Stability and Growth Pact, due consideration should be given to strengthening its economic rationale and implementation. [...] The preventive arm of the Pact should be strengthened. [...]

The focus on debt and sustainability should be enhanced.' (end of quote) The ECB has also expressed its backing to these ideas.

Let me now say a few words on how to improve the implementation of the corrective measures, that is on how to improve the implementation of the excessive deficit procedure. An essential point to keep in mind here is that if the ideas presented above are actually implemented and the preventive action works satisfactorily, it should be much less frequent to see Member States with excessive deficits in the future.

While the SGP spells out currently situations that could be considered exceptional, for example the case of a recession, these definitions could be probably revised to take into account the structural changes in an enlarged EU economy. This debate is not so much about flexibility but about facing the economic reality of a Union that has a very low growth potential and faces structural problems that hinder its economic performance. But in order to avoid misunderstandings, let me stress, that this new approach would not have changed the need to launch procedures vis-à-vis the countries currently under the Treaty procedure for the correction of excessive deficits.

For countries in excessive deficit, prompt and firm corrective action would continue to be necessary. Nevertheless, such action should not be taken at any cost. Accordingly, it seems worth revisiting the provisions of the SGP specifying the adjustment path for the correction of an excessive deficit in order to consider cyclical conditions faced by the country and risks to sustainability.

The principle remains that an excessive deficit should be corrected promptly, but the influence of economic developments outside the control of the government on the budgetary outcome should be taken into account. The Commission has already taken steps to this end, for example by considering economic developments in its recommendations for the correction of excessive deficit concerning a number of countries in EDP in the past. However, the framework would benefit from becoming more transparent on this aspect. Clearly, a balance must be maintained between making changes in this direction and the need to have rules which ensure sufficient deterrence and are enforceable.

Unfortunately, I noted that the debate following the release of the Commission Communication has focused mainly on this specific aspect of how we would like to improve the implementation of the SGP. Many, including the ECB, have seen this as a major attempt to the credibility of the rules, as if one pillar of this framework would be eroded. I believe that strengthening the link between our rules and economic reality would rather go in the direction of increasing the standing of our framework, and therefore its effectiveness.

**Finally**, let me mention the last element of our suggestions: budgetary policies should better contribute to progress towards achieving the economic objectives set in the Lisbon strategy. This can be achieved by improving the quality of budgets on the expenditure and the revenue side. For this purpose, the link between the Broad Economic Policy Guidelines and the Stability and Growth Pact should be reinforced.

In practical terms, a more efficient contribution of the EU to the conduct of national policies could be achieved by bringing the EU budgetary policy co-ordination calendar more into line with the general economic policy co-ordination cycle. This would mainly imply advancing the submission and assessment of the Stability and Convergence Programmes, which would become a strategic ex-ante exercise earlier in the year. As a result, the content of the Broad Economic Policy guidelines and the Opinions on the Programmes could be better taken into account in the preparation of national budgets in the second part of the year.

The suggested creation of the European and national semesters for economic policy would strengthen the link between the submission and assessment of the stability and convergence programmes and the Broad Economic Policy Guidelines, while at the same time increase their effects on national budgetary procedures. It would allow budgetary policy to be placed in a broader context through a comprehensive analysis of policy choices and of their contribution to the overall objective of enhancing the Member States' growth potential.

In this presentation I have highlighted the key objectives to be pursued in the revision of the economic and budgetary co-ordination framework.

Strengthening and clarifying the Stability and Growth Pact is a necessary step to this end. The declaration of the European Council on the Stability and Growth Pact last June and the statement of the informal ECOFIN Council earlier this month are reassuring on the intention of Member States to move in that direction. The ECB has also stressed the room for improvement which exists.

In the months ahead, the specific ways to improve the EU budgetary framework will have to be worked out. We will discuss them together with the Member States and the European Central Bank. Following technical work which has already started within the Economic and Financial Committee on the basis of more detailed contributions by the Commission, we look forward to the discussion to be held by the ECOFIN in November which will take stock of the progress made.

Let me conclude by saying that if in the first five years of EMU our economic governance framework did a good job in contributing to the establishment of macroeconomic stability, the experience tells us that further improvements are needed to ensure the sustainability of public finances, increase their contribution to growth and reflect the growing economic diversity in the Union. I believe that the window of opportunity which is open in front of us should not be wasted. I trust that Member States will consider conscientiously our suggestions to strengthen the EU framework for economic governance.

Thank you for your attention.