

Speech of . Didier Reynders, Deputy Prime minister and minister for Finance and Institutional reforms, before the Assembly of Parliamentary Finance Committees of the National Parliaments

It is a pleasure for me to exchange views on an issue which is at the core of the future stability of the Union, and in particular of the euro area.

It is not a coincidence but the timing is ideal: the Commission will adopt on 29 September a package of legislation translating urgent policy proposals for the improvement of economic governance and stability within the Union into concrete legal instruments. In parallel, in less than one month, the Van Rompuy Task force will present its report to the European Council.

We have made significant progress under the Belgian Presidency to reinforce financial supervision at the European level and to try to correct some market deficiencies that materialized during the financial crisis.

But let me first go back a few months ago. We then played the crisis managers of last resort as we were forced to intervene to avoid a major collapse of the financial sector.

Beginning of May, we were close to a meltdown that could have been as severe as the one which occurred after the bankruptcy of Lehman Brothers. Again speed was critical : in a week-end, the Heads of State of Governments of the euro area agreed to establish a European Financial Stability Fund to support countries facing major difficulties to access capital markets. In parallel the ECB intervened on the markets. Both actions succeeded in preserving the integrity of the euro area.

Now that the most acute part of the crisis is over, we need to address some weaknesses in the construction of the single currency.

Let me remind you rapidly the context before envisaging what should be done to strengthen the institutional structure of the euro area. At the cornerstone of the EMU, linking a centralised monetary policy and a decentralised budgetary process, we find the well-known Stability and Growth Pact (SGP).

The aim of the SGP is to guarantee:

- macroeconomic stability, supporting price stability and growth
- avoidance of bail out, explicitly foreseen in the Treaty;

The SGP has the enormous advantage of being understandable (at least the core of it) to everyone:

- maximum of 3 % deficit,

- gross public debt not exceeding 60 % or declining at a satisfactory pace
- and finally sanctions for continuous misbehaviour

Later on, additional commitments were taken by euro-area countries to move to safer budgetary positions, the so-called medium term objectives.

But like all new babies, the SGP went through some child diseases. It actually experienced three different crises, or at least moments when its future was to some extent questioned :

- First in 2003-2005 when a clear majority of member states were in EDP;
- Then in 2009, when the financial crisis not only negatively impacted growth but also required very large interventions in favour of the financial sector;
 - Member states were asked to engage in a fiscal stimulus; which gave the impression that the objectives of the SGP had become obsolete or inadapted to the circumstances;
 - The fiscal stimuli that were recommended by the Commission and agreed on by the European council (=the so called European recovery plan) sent in any case confusing signals as to the relevance of the SGP itself.
- Finally, in 2010, the Greek crisis led to the creation of financial support mechanisms that some have considered to be bail out funds in disguise;

Now, a bail out is when one lets a debtor off the hook, which has not been the case with the Greek intervention (participating countries do not take over any liabilities from Greece and the support comes with interest rates broadly aligned with the typical IMF deals).

To many observers, the SGP was a stillborn child. But the parents were patient. In 2005, it benefited from changes that gave it more teeth and, at the same time, allowed us to get rid of some of its rigidities.

We are all aware that we live in a world of second-best solutions and that the design of the SGP was far from perfect from the beginning in order to achieve its objectives. At the same time, we have to recognize that the Pact did make a difference. Without it, budget deficits in a number of Member States would have been considerably higher. It made a difference because, in many countries, it became anchored in the minds of governments, parliaments, the press or public opinions (unfortunately not necessarily in all four of them in all member states)

The last crisis made it clear that the decision-making process supporting the SGP was not designed in a way that could prevent excessive deficits from emerging and did not allow to correct them sufficiently rapidly.

Ultimately, the global financial and economic crisis, combined with major macroeconomic imbalances within the euro area created the risk of a major sovereign debt crisis. In fact, the

crisis revealed some underlying competitiveness issues, mainly but not only in some southern European countries, and also inappropriate fiscal policies.

We have thus come to the conclusion that the child needs new medicine: the Van Rompuy task force (VR TF) was set up to revise not only the SGP but also the whole governance around the SGP. The discussions are not yet finished but the general thrust is clear and is based on remedies to cope with the flaws of the pact, which are rather flaws of implementation than flaws of intrinsic design.

In parallel, discussions are on-going to improve the quality of the assessment of a country's solvency and to reduce the risks of speculation in a more interconnected financial market.

From the outset, it became clear that measures had to be taken for all the 27 countries - having in mind that UK was left off the hook for sanctions when the Maastricht Treaty was signed - but that they would need to be more stringent for euro area countries. This may seem odd but it is natural since the danger of spill-over (which we have now observed with the Greek case, where financial turbulence spilled over to some other Member States) is far greater within the EMU than outside it.

Let me give you some indications about the mix of medicine which is in preparation to help this child become a self-sufficient teenager. The three main components of the treatment are:

- Fiscal discipline
- Macroeconomic surveillance
- And crisis management.

Starting with fiscal discipline, the first priority is to improve the quality of the statistical reporting. The Greek dossier was a case in point. Greek statistical reporting proved unreliable and there is a need for more independence and reliance in the national fiscal assessment. The Ecofin recently approved measures to beef up statistical oversight of national statistical reporting

But the first real prescription from "doctor Van Rompuy" was the setting-up of the European Economic Semester. The timing of the submission of the stability and convergence programs will be changed. But it is not, of course, a pure question of timing. The objective is to allow the Commission to check the general thrust of the budgets at an early stage, before it goes to national parliaments. This has provoked worries in some corners (danger that the European semester would impinge on rights of sovereign parliaments) but the European council has decided that the system has to respect national budgetary procedures. The Commission merely wants to check whether the draft budget can be considered to rest on realistic assumptions; it will not pronounce itself on decisions on spending and taxation which belong to national sovereignty. In this context, the Ecofin recently approved the modification of the code of conduct.

In order to anchor budgetary discipline, the Commission wants to go further and wants that member states devise fiscal frameworks, i.e. sets of rules and procedures that anchor a medium term path towards achieving the MTO. Setting for instance binding spending

ceilings. It is heavily inspired by the Scandinavian experience. But the question is whether we are not transgressing here the limits of subsidiarity. Belgium for instance reduced its debt from 134 % of GDP in 1993 to 85 % in 2008 without a legally binding fiscal framework. It relied heavily, though, on the work of the High Finance Council, an advisory body that was able to set out a medium term path for the budgetary policy of the federal and local governments that created a valuable basis from fiscal consolidation. It also led to a stronger tradition of regular budget reviews. One should also have in mind that detailed fiscal frameworks can run into difficulties in countries where regions have strong autonomy. On the other hand, it is not clear that informal set ups are sufficient in times of acute crisis.

One of the flaws of the present SGP is that it only foresees “curative” drugs in your medicine, not preventive ones. The other flaw was that the sanction of a fine was to be considered as a kind of “nuclear” option, which explains why it has never been applied in practice due to a lack of credibility. As a consequence proposals are being floated, based on creating a gamut of sanctions, which would include preventive ones, go in crescendo and have a high degree of automatism (including a reversal of voting majorities).

Some of them are financial, some are not financial. Most of them can be applied without modifying the Treaty, but others require a modification of the Treaty. I would rather not elaborate further on this aspect because this is the part where the legal and technical aspects to be resolved are clearly the greatest. One should moreover keep in mind that sanctions would definitely be much more directed to euro member states than member states outside the euro area.

High or rapidly increasing public debt can herald serious problems, justifying the launch of the excessive deficit procedure. Though the Treaty contains obligations on debt and deficit, the surveillance has in practice focused on the deficits (3%) and much less on debt. There is now a tendency to attach more importance to debt and even to create an excessive debt procedure aside the excessive deficit procedure. But at the same time things have to be put into perspective: the countries (in and outside Europe) who have slid most into trouble are the ones where public debt was just an aggravating factor; the main cause consisted of a mix of run away household debt, massive corporate debt, stark losses of competitiveness and fragile banks balance sheets.

Regarding macroeconomic surveillance, it is important to recognize the large spillovers from macroeconomic policies of one country on all other participating countries in the euro area. Economic imbalances were at the root of the problems encountered in several countries. Countries which had experienced strong economic growth and surpluses for years suddenly got into trouble. This explains why the Commission now proposes an excessive imbalances procedure (similar to the two other ones). Member states would be required to correct their economic policies on time. Significant deteriorations of external positions and losses of competitiveness have to be monitored closely and addressed decisively. From this perspective, surveillance has to become more encompassing.

But of course, a good prevention system will not allow to avoid all crises. Financial support mechanisms (Greek bilateral loans, EFSM, EFSF...) have been part of an ad hoc solution.

These can not be considered as a bail-out: they are certainly not a present to the Greek government. But the EFSF exists only for three years. The question is: what will follow?

It would be a dangerous signal to the markets to take away this shock absorber. Crisis management mechanisms should avoid crises without creating moral hazard. Some are floating the idea of an organized default. But, up till now; I have mostly seen messy defaults in history. On the other hand, one must admit that private creditors did not participate in any burden sharing. Maybe we should reassess the situation in the course of next year, after having taken some distance, and see then where to go from where we are today.

To conclude let me stress the following. We would not need the whole machinery that is now being developed if a strong budgetary discipline was in each member state anchored in the mentality of governments, parliaments, the press and the whole population. It is not a coincidence that the member states which have the best budgetary policy are the ones where it is anchored at the four levels and where unrealistic budgetary promises are considered not politically credible.

Therefore I invite you to participate in this anchoring operation because this will be the best guarantee against fiscal derailment. But this requires courage from parliamentarians, not demanding for more spending than the government proposes but less. But this is the hallmark of a good parliamentarian: he should lead his voters, not follow them.

Let me also insist on the fact that the new medicine should create the foundations for an autonomous and reasonable system creating sustainable growth and jobs.
