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**Speech by President Herman Van Rompuy
at the Brussels Economic Forum 2014 - 4th Annual
Tommaso Padoa-Schioppa Lecture**

It is a pleasure to be here this afternoon and to close this year's Brussels Economic Forum. When I spoke here in 2010, Tommaso Padoa-Schioppa was of course still among us. I met him several times in the first year of my mandate. Four years later it is very humbling for me to be here again and to give a lecture named after him.

You have had a long and fruitful day behind you discussing the various aspects of generating a sustainable economic recovery in Europe. I imagine that the debate has been lively, if not contentious. After all, while growth is coming back, the recovery remains weak and uneven. And...the level of unemployment in Europe is still unacceptably high.

I presume that in your reflections, some of you will have focussed more on demand side of issues, while others will have stressed the importance of aspects of the supply side. These different view points remind me of another distinction which is that often made between the roles and responsibilities of debtors and creditors. In my view, this distinction is to some extent misleading. Behind every reckless debtor, there is a reckless creditor. Of course, the political issue is how to apportion the costs of their respective failures....

But I do not want to avoid the issue of our differences and divergences, since these are essential. In fact, *dealing* with differences and confronting them is perhaps the very "*raison d'être*" of the European Union. It has been the essence of my job as European Council President over the last five years to understand differences and try to bridge them.

P R E S S

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So, what I would like to do over the next twenty minutes or so is to take a step back from the more forward looking discussions you had this afternoon and close the circle opened this morning by looking back again. Because in my mind, there is a huge risk of misunderstanding and policy paralysis going forward unless there is a greater degree of consensus on the past.

I would like to turn to some key differences of mindset inside the European Union concerning three crisis-related topics. The first set of differences relates to the origin of the crisis and its narrative. The second relates to the policy response, to the crisis management and the adjustment strategy. The third and final one relates to the architecture and the future of the euro area.

So, first, on the narrative about the origins of the crisis. It is striking and unsettling, but not surprising, that some six years after the onset of the biggest financial crisis since the 30s, there is still no common understanding of what happened. Important differences amongst intellectuals and political leaders remain.

For some, this crisis is merely, was merely a financial crisis: imported from the United States and that spread to an under-regulated and poorly supervised financial system.

For others, it is the simple result of excessive public debt building up over the years, due to bad fiscal policies at the national level and an inadequate economic governance at the European level.

For yet others, it is a crisis of competitiveness, on the supply side, that started with divergent dynamics in terms of labour costs versus productivity, resulting in large external imbalances that need to be adjusted; while for others again, the crisis is essentially one of lack of demand, that can be addressed by fiscal expansion, especially in the countries with an important surplus on their current account, and whose effects would then trickle through to countries where the degree of slack remains large.

And that is not all. Others interpret the events first and foremost as a self-fulfilling monetary crisis, precipitated by an inadequate monetary policy response to a financial shock; while others look at it as a structural growth crisis of European and advanced economies, which raises the possibility of a form of long-term stagnation.

My point is this. These differences in the understanding of the crisis are deep and should not be neglected, since they impact our response to the crisis. They often reflect different cultural, historical and intellectual traditions, including respective histories of economic facts and economic thought.

Unlike the United States, which can build on a shared intellectual heritage and, even more, on a common economic history, Europe's historic self-understanding is diverse and remains largely national. Our Union, its institutions and the euro are young. There was for instance no real collective response to the crisis of the 1930s in Europe, but rather a series of national policies, while in the United States the collective and institutional memory of the 1930s has been at the heart of the policy response in 2008/2009.

Our memory of the 1930s really started with the Versailles Treaty in 1919, which is widely recognized as having contributed to destroy the economic and political foundation of Weimar Germany. Keynes forecasted this in his striking book of 1919: *The Economic Consequences of the Peace*.

After the Great Crash in 1929, France was the country that stuck longest to the Gold Standard. By doing so, it played a part in the global monetary tightening, which in turn contributed to transform the crash of '29, and the European banking crisis of 1931 into the Great Depression... These moments, and if I may say, these deflationary policy mistakes have shaped economic thinking in France. And interestingly, they have shaped economic thinking much more so than the more recent failed attempts in the early 1980s of "*relance keynésienne*".

Germany, of course, has a different historical account and intellectual memory. It vividly remembers the hyper-inflation of the 1920s – itself largely caused by the urgency to pay down the reparation debt. The fact that the Keynesian policies of the 1930s were undertaken by the Nazi regime also left traces. These memories have resulted in a strong scepticism towards economic policy discretion as well as towards policies susceptible to create inflation. These concerns, theorised by such thinkers as Ludwig Von Mises, are at the root of the German *ordo-liberalism* and the fear of "moral hazard". This "*Angst*" has of course underpinned quite naturally and I would say without effort the credibility of the Bundesbank; a credibility of course the ECB first had to earn.

France, to summarise, got scared of deflation, Germany of inflation!

These deep differences in economic analyses are real and come a long way. They certainly influence economic thinking in the North and the South but they do not need to be divisive per se and they don't have to repeat themselves. Indeed, Germany's economic model after the war, identified closely with the name of the first minister of economy and later chancellor Ludwig Erhard, was the social market economy, "*die soziale Marktwirtschaft*". This was in spirit not very different from what was being built elsewhere in the European Community. Indeed, this new Community and later the EU proves that these differences can also be a strength on which to build a more consensual narrative of the crisis and a multifaceted economic policy response.

I now would like to move to my second point: the policy response.

Of course it was partly informed by a rich and diverse economic culture, as just described. But it was also driven by events. Indeed, the financial panic that set in during this crisis has forced a number of rapid reactions, be it the extraordinary liquidity support of the European Central Bank, or the creation of financial safety nets, such as the EFSF and then the ESM.

But even in dealing with the emergency, our economic strategy was the subject of intense discussions and debates between those who defended "shock and awe" measures to promote confidence and those that remained concerned with incentives and moral hazard.

At the onset of the global financial crisis in 2008/2009, our policy response favoured fiscal and monetary expansion, alongside the US and all G20 economies. In fact, in line with IMF recommendations, the European Commission at the time proposed a large and coordinated discretionary stimulus package. However, our policy response became more challenging when, late 2009/early 2010, the crisis turned more specifically European.

The eurozone episode of the crisis provoked important debates about our economic policy and our monetary union.

In particular, the loss of confidence in government bond markets provoked by the Greek crisis early 2010 was a real shock to which we were not prepared.

I entered this office at the onset of the crisis, and I discovered to my great surprise that there was nothing to deal with such a crisis – no instruments, no macro-economic oversight, no rescue mechanisms... We had to invent it from scratch.

We built these rescue mechanisms, first improvising somewhat in the urgency and then more solidly with the European Stability Mechanism.

The other response to the debt crisis was a fiscal consolidation across a wide range of countries, in order to restore market confidence and to correct unsustainable fiscal developments. But the panic in government bond markets broke the monetary policy transmission channels. It created a self-fulfilling crisis, in which countries whose debt outlook in other circumstances was perfectly sustainable were threatened. This dynamic – after many dangerous episodes – eventually led the European Central Bank to its famous decision of the summer of 2012, in which it effectively committed to kill such self-fulfilling dynamics by eliminating the anticipation of a break up of the monetary union.

I should add here however, *especially since some commentators attribute the end of the crisis merely to a few magic words of Mario Draghi...*, that the Central Bank was only able to take this decision because of the preliminary political decision, by the EU's Heads of State and Government to build a banking union. This was the famous European Council of June 2012, so just weeks before Draghi's statement; he himself said to me, during that Council, that this was exactly the game-changer he needed.

Let's come back to our overall economic strategy as developed in the stages of the crisis, it had in fact *four* legs.

If the strategy today seems to be bearing fruit, in terms of stability and of growth, it is precisely thanks to the fact that it took all aspects into account.

In any case, historians will judge the results of all these actions – and their interplay. Perhaps it is too soon to make a judgment now. Remember what Prime Minister Zhou Enlai once said when asked about his assessment of the French Revolution: "Too soon to judge"!

Now, what were these four legs of our strategy?

First, ending financial panic "by any means necessary", if I may use this expression. This was largely an exercise of firefighting, *roughly from spring 2010 to early 2012*, which sometimes distracted us from more concerted and determined actions, in dealing with the banking sector for instance as we are doing now but belatedly. People tend to forget that we were in a survival crisis. In a survival crisis!

Second, gradual and growth-friendly adjustment. This included a flexible consolidation effort, with emphasis on the structural balance rather than on the nominal targets. The successive deadline extensions granted to meet the nominal targets testify to the embedded flexibility in the Growth and Stability Pact. But from March 2010 we recognised that the origins of the crisis were not just fiscal and we also included a new focus on external imbalances (*I remind you of the Taskforce on Economic Governance I chaired*). Countries like Ireland or Spain, fully compliant with the Stability Pact before the crisis, illustrated that this crisis was not only a fiscal crisis. It was and still is also the massive hangover that you experience once a credit and housing boom bursts. And so we know that we have to be as worried about credit booms as about credit busts. Across Europe, the boom was masking severe underlying weaknesses and increasingly, as debts were being accumulated by the private sector, the boom became a problem in itself. Let us not forget that in 2008 Ireland and Spain were both triple A rated and Ireland the country with one of the biggest GDP per capita in the Union.... But now we are paying the price of this reckless accumulation of debt and of the unwillingness by many to stop the party in time.

And this is (*third point*) why we have collectively tried to cushion as much as possible the short-term costs of the adjustment. The ECB played its part through monetary policy, also through non-standard measures. Only last week did the Governing Council announce a whole range of new measures aimed at mitigating the risks of very low inflation.

Separately, the national governments, both individually and jointly as a Union, took measures to boost credit to the economy and support employment, in particular youth employment. For instance, we mobilised eight billion euro in the new EU budget for this specific purpose. Also, Member States injected ten billion euro of fresh capital in the European Investment Bank so that it can support the adjustment, and can finance an estimated sixty billion euro worth of new investment projects over three years. Indeed, more than twenty billion euro of additional loans were signed in 2013. And this is good news!

Fourthly, we have set in motion a process of repairing and rebuilding the architecture of the euro area. This is both in motion and in debate, and I want to focus the third and last overall part of my intervention on this.

For me, also in my dealings with leaders, the turning point in the crisis was the spring of 2012. That's when we went from ad-hoc actions to a systemic approach.

After our focus on sheer survival, there was a realisation in the spring of the 2012 that we were not facing a simple economic crisis of Greece, Spain or Portugal, not a series of individual problems, but that we also had a collective problem, and that we had to do something about it together. We also realised that this more systemic crisis of our monetary union could only be addressed by spelling out the direction the monetary union would take. That is why I asked for a mandate of the European Council in May 2012 to draft a report on the future of the Economic and Monetary Union.

In June, then, I presented this report to the European Council. It was drafted with my colleagues of the Commission, the Eurogroup and the ECB, with the aim of presenting a roadmap to buttress the architecture of our monetary union, over and above all the improvements since 2009. Almost two years later, I am pleased to say that we have made some progress *Towards a Genuine and Economic Monetary Union*. In particular with decisive steps towards the completion of a banking union, which was indeed a gaping hole and a source of instability in our monetary union.

To me, the banking union is the biggest policy change since the introduction of the euro itself, and to EU standards, it is all happening with the speed of light. Currently, an Asset Quality Review of the banking sector, led by the ECB, is taking place. This is stimulating, even before its conclusion, a deep balance sheet clean up, loss recognition and important amounts of capital raising. It will result in a sounder financial sector, that is able to restore credit flows and thus support the recovery.

More broadly, though, the decision on the banking union should give us hope that indeed we are able to embark on major reforms and can convince the electorate of their necessity. I remember vividly only two years ago how careful we were not to employ the term '*banking union*', out of a concern that this was politically too sensitive and people would go up the barricades. But as far as I can tell the banking union was not a contentious subject in the recent European elections and hence cannot be blamed for the strong results of Eurosceptic parties. In light of all the competences discussion, this is truly remarkable! "*Ça donne à réfléchir!*"

However, aside from the banking union, there are other issues related to the deepening of the economic and fiscal union. To be fair, some of these issues remain open questions on which there is no clear intellectual consensus (*this is perhaps your job*) and even less of a political consensus (*this is my kind of job or of my successor*).

These were and remain sensitive issues that invite us to revisit the discussions held by the Delors Committee, in the run-up to the euro. For some, the Maastricht architecture, now complemented with the solidarity mechanism and the banking union, is perfectly sufficient. For others, this is not enough. For them, deeper economic policy coordination and elements of risk sharing beyond the banking union remain essential components of any mature monetary union. I would tend to agree. I think it is imperative for the EMU roadmap to stay alive. Regrettably, and having experienced this first hand in the context of the 'contractual arrangements' between Commission, Council and Member States on structural reform, once the existential threat by the crisis is gone, so is the appetite for more institutional change. The old ghosts of a loss of sovereignty and 'too much or too little' solidarity reappear. Unfortunately!

Of course, more profound changes also require an intellectual consensus, which takes time to reach and even more time to build acceptance in the wider public. More profound changes also require trust in each other's financial and economic policies among member states. Finally, they may also receive more support in an environment of growth and job creation. This gets me back to your discussions today on how to secure the recovery and on how to broaden and deepen it. This remains of course the core of the matter.
