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Europe must buck short-term tendencies

di Mario Monti

This week's European Council meeting is expected to launch a mechanism to safeguard the financial stability of the euro area and a framework to strengthen economic governance, through more rigorous surveillance. These are important steps forward. The new system of governance, however, has a number of shortcomings. Unless they are addressed soon the new system will be exposed to the very illness policymakers are trying to eradicate from the markets: short-termism.

Short-termism in the exercise of discipline? Is this not a contradiction in terms? Not really. Indeed, we saw this in the infancy of the stability pact. When it was negotiated in 1996, there was a short-term imperative: to reassure German public opinion that the euro would be as strong as the D-Mark, even if countries with a tradition of financial indiscipline were to join. Had the pact been economically sounder but less reassuring prima facie, perhaps German concerns would not have been overcome and the euro would not exist.

As the euro reached its fifth birthday, however, its "parents" had second thoughts on the stability pact. In 2003, Germany and France jointly pressed the Council of Finance Ministers not to apply to them the enforcement procedures that, based on the pact, the Commission had proposed. As candidly stated by Chancellor Angela Merkel last spring, that undermined the credibility of the stability pact, thus encouraging several countries not to take it too seriously.

Today – understandably in light of the Greek and Irish crises – German public opinion is hungry for reassurance on renewed discipline. The German authorities, and their supporters, again run the risk of giving priority to such a key but short-term objective at the expense of the more vital objective of a sustainable discipline, enforceable even in hard times.

I have had great sympathy for the German authorities for more than 30 years. I hope they can display strong leadership domestically but also, in line with their best tradition since the 1950s, lead the adoption in Europe of structurally correct and long-term oriented policies, rather than policies inspired by short-term concerns. Five improvements should be considered.

1) Less "political" enforcement: The commission's role should be increased, more than already envisaged in the framework. The place where enforcement measures tends to be bent by national influences is not the Commission, as implied by the framework, but the council itself.

2) More long-term discipline: The framework is based largely on the assumption that all public spending, even genuine public investment to expand the potential for growth, is inherently bad and should not be financed by debt, while all private spending, even consumption, is inherently good and can be financed by debt. This is not a reasonable criterion, particularly for the EU, which aspires to serve the interests of future generations. When we formulated the pact, I as a commissioner advocated, unsuccessfully, that the role of investments should be recognised and we should agree on rigorous definitions of public investment, while the ceiling on the deficit due to public current expenditure could be set at zero. The new framework introduces adjustments, but does not go far enough.

3) Public debt/gross domestic product: The need to reduce the debt ratio, not just to contain the deficit, is rightly emphasised in the new framework. The downwards adjustment path for each country will have to be designed to maintain pressure on structural budgetary measures, while not triggering in the countries concerned, and indirectly throughout the EU, a contraction.

4) E-bonds to strengthen market discipline: To promote effective and sustainable discipline, the common issuance of euro bonds on behalf of euro area governments would have several positive effects, three of which should be particularly appealing to Germany. Germany itself would not have to give up the advantage it enjoys in terms of lower cost of financing relative to less disciplined countries. The scheme would increase the disciplinary effect of the markets on the latter countries. Finally, the ECB could put an end to its generous interventions to support governments in difficulty, which is hardly in line with its mandate.

5) Discipline requires growth: The economic pillar – the “e” in Emu – has two components: economic union, supposed to underpin monetary union; and the governance of economic policies, other than monetary policy which is assigned to the European Central Bank. The proposed framework goes a long way towards providing economic governance, but neglects economic union. The uneven development of a really integrated single market lies behind divergences in competitiveness and the inadequate economic performance of the EU, the eurozone in particular.

The initiatives launched by the president of the commission on the single market provide the basis for a much stronger economic pillar, enabling monetary union to deliver better economic performances. This should receive committed political backing from the president of the European Council, hopefully supported by Germany. Citizens would then see the EU has a coherent policy embracing discipline and growth and the council will show the EU is indeed able to make progress under the pressure of crises.

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