

Warsaw 2007 - Conclusions

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ROSS WALKER, RAPPORTEUR

Conclusions

There is a broad consensus on what is needed (the defence of independent monetary policy, fiscal consolidation, the completion of the single market, structural reforms to raise productivity etc). The main issue centres on how to achieve this in practice.

The present economic recovery in Europe must not allow slippage in the reform process (the recovery is as much cyclical as structural). Structural and fiscal reforms will be more palatable against a backdrop of economic growth and job creation. Recent financial market turmoil and the more pronounced slowdown in the US make economic reform in Europe even more pressing.

Economic reform is primarily the responsibility of national governments but EU-level involvement could include benchmarking, the spread of best-practice and "peer pressure" - the ECB and Commission could be more explicit in rating the performance of national governments.

It is not only fiscal deficits which adversely affect Europe. There is also a deficit in political courage. Politicians must recognise the limits imposed by globalisation - you can't buck the market - but must also respect ECB independence and implement the Lisbon Agenda.

There is a case for some reform to the functioning of central banks to bolster their independence and to help secure wider monetary and macroeconomic stability. Two key suggestions were made:

1. To allow central banks, in pursuing their inflation target objectives, a degree of greater discretion to respond to developments in money, credit and asset markets. This is not to advocate formal asset price targeting (it is for markets to determine asset values), but rather to allow central banks more scope to pre-empt potentially inflationary or destabilising developments elsewhere in the economy and financial system. A case can be made that structural changes in the global economy - deflationary price pressures emanating from Asia - allowed unusually accommodative monetary policy conditions in the West, which in turn fuelled asset price bubbles (eg, housing markets).

2. The ECB's institutional structures and processes at the policy-making level could be streamlined. The present Governing Council is rather large and unwieldy: all member states' central banks are represented, whereas the US Fed is leaner, with rotating voting members. The decision-making process is rather opaque - no vote is published - which may undermine fuel suspicions that national interests exert undue influence.

Currency depreciation is not the route to sustained economic growth and low inflation in the medium-term - political protests about € strength are an unhelpful distraction from the real issues. The main currency imbalances in the global economy relate not to the US \$ but to the Chinese yuan which is pegged to the \$ at artificially low rates (and is therefore also depreciating against €). EU institutions should continue to encourage the Chinese authorities to liberalise their currency regime.

Protectionism and the incomplete SEM remain major barriers to raising Europe's productivity performance. National governments which attempt to block cross-border M&A activity should be subject to tougher penalties - similar to the principles which underpinned the original SGP.

The recent turbulence in financial markets has raised questions about the appropriate response of central banks and regulators. It is too soon to evaluate recent events, but the global nature of this crisis suggests there may have been insufficient co-ordination between different national regulators. Concerns were expressed about the consequences of large liquidity injections and "bail outs".

Tax competition remains preferable to tax harmonisation. Some scepticism was expressed about proposals to harmonise corporate tax bases in order to reduce tax rates. Private sector companies are a better judge of the attractiveness of tax systems than bureaucrats.