2-001

COMMITTEE ON ECONOMIC AND MONETARY AFFAIRS

TUESDAY, 19 APRIL 2005

Hearing on the appointment of Mr Bini Smaghi as a member of the Executive Board of the European Central Bank

Consultation of the European Parliament pursuant to the Council Recommendation of 8 March 2005

(Article 112(2) of the EC Treaty)

2-002

IN THE CHAIR: MRS BERÈS

(The sitting was opened at 11.05 a.m.)

2-003

Exchange of views with Mr Bini Smaghi, candidate for member of the ECB Executive Board

2-004

President. – Ladies and gentlemen, I propose that we move on to the next item on our agenda. As you will be aware, this is the hearing of Mr Bini Smaghi, who has been nominated by the European Council to replace Mr Padoa-Schioppa as a member of the ECB's Executive Board.

As is our custom, we sent a written questionnaire to Mr Bini Smaghi, to which he was kind enough to provide a response. After consulting all the political group coordinators, we published his answers to the questionnaire last Friday, and this should act as a stimulus for the debate we will hold with him today.

I should like to extend a warm welcome to you, Mr Bini Smaghi, and to remind you that the committee that you are appearing before today is in charge of conducting the Monetary Dialogue. The latter is of great significance in terms of legitimising and strengthening the authority of the institution to which you have been nominated and, as you will be aware, we attach a great deal of importance both to the Monetary Dialogue itself and to its quality and depth.

Each of your colleagues has had the right to take part in a hearing similar to the one we are holding today, and I will start by giving you the floor straight away in order for you to give an introductory statement. A number of committee members will then put questions to you, and we will work to strict time limits in order to allow each political group to take part in the debate.

I will now give you the floor, Mr Bini Smaghi.

2-006

Bini Smaghi, *nominee for the Executive Board of the European Central Bank.* **–** *(IT)* Madam President, I should like to begin this hearing with a few introductory comments, beginning with a personal statement expressing my reaction to my nomination as a member of the European Central Bank's Executive Board. Above all, it is a great honour, as the European Central Bank is one of the key institutions of the Union, and I am conscious of the great responsibility it bears for the citizens' wellbeing. For me, it is also – and above all – a great pleasure and source of personal satisfaction, as it represents the synthesis of the two great enthusiasms which have marked my professional life, my intellectual development and my social commitment during these years, namely European integration, on the one hand, and economic policy, and particularly monetary policy, on the other.

For me, Europe represents what I could term an almost genetic reality. I come from a family of committed Europeans: my father was an official in the European Commission and I lived in Brussels throughout my years at school and university. I recall my initial studies at the University of Louvain, in the mid-1970s, on the hypothesis of European monetary union, in particular the All Saint's Day Manifesto, and my thesis with Robert Triffin entitled 'Theoretical justification for foreign exchange management', which reflected the debate at that time prior to the creation of the European Monetary System.

After a period of study in the United States, where I obtained a PhD with a thesis on international finance, I began work in the research department of the Bank of Italy, dealing, in particular, with the European Monetary System and the monetary framework for Europe, and I participated, as a substitute, in the work of the Monetary Committee in preparation for the Maastricht Treaty. After signature of the Treaty, very few people believed that monetary union would be achieved within the planned timescale. Many felt, particularly after the currency crisis of 1992-93, a crisis linked to ratification of the treaty, that the goal was likely to prove unattainable.

I held the opposite view. That crisis showed that the road map set out in the treaty was the only viable one and that currency stability in Europe could not be guaranteed solely through mechanisms for cooperation among national

authorities. Institutional change was also necessary, and in particular the change prescribed in the treaty. It was for that reason that, with a handful of colleagues, I left for Frankfurt in 1994 to create the European Monetary Institute, the precursor of the European Central Bank. To take part in creating a new monetary institution – one, moreover, on a European scale – was, to say the least, a stimulating experience. Europe has continued to be a central part of my professional life in the Italian Ministry of the Economy, from 1998 to the present. Europe, the currency and economic policy have been the defining aspects of my professional life and will remain so over the coming years.

In the first years of its existence, the European Central Bank cemented its own role, creating stable purchasing power for the population, overcoming problems and dealing successfully with numerous challenges. Others remain, if we look ahead to the next few years, and I should like to devote the remainder of my comments to an illustration of the challenges which now face the European Central Bank.

One of the greatest of these challenges concerns the political and institutional context in which the European Central Bank is operating. It is a context largely independent of the central bank itself, and one on which it can have little impact, but from which it cannot remain aloof: a central banker cannot ignore the context in which he is operating nor can he refrain from wondering and asking questions about the ambient political and institutional framework.

When the Maastricht Treaty was signed, many people in Europe, and above all outside it, doubted whether monetary union could survive without the support of political union, and I recall that, in an opinion given by the Bundesbank to the German Government, political union was considered as an essential condition for the success of monetary union.

My reply, as a citizen committed to European integration, was – and remains – that the European Union is a political union. It is a different sort of union, with different institutions, and is the result of a different stimulus, namely the aspiration of States and peoples to become increasingly united, to build together and to overcome their common problems together. It is a political union as it reflects a joint commitment, which is why the Treaty of Rome refers to the ever-closer union of the peoples of Europe. This has been true up to now, but it is fair to ask, as many people are asking, if it will continue to apply in the future. We cannot ignore the present uncertainties, not only of an institutional nature but also on the probable direction of the integration process.

The European Central Bank is one of the European Union's key institutions, interacting with its citizens, day after day, through the medium of the currency. The euro is evidence that Europe can provide its own citizens with a common asset – monetary stability – better than any other national institution, and this is a measure of how we apply the principle of subsidiarity in Europe, a fundamental principle of our Union. Despite that, the euro and its central bank are exposed to the risks of a political scenario in the making, one which has not yet fully crystallised.

What would happen if the integration process, which was supposed to accompany monetary union, ground to a halt? What would happen if there ceased to be a commitment to tackle the problems jointly? No one has ever believed that the Union would be achieved in a day, in a single step. The experience of the last 50 years has shown that building Europe is a gradual process, with stages which are sometimes gradual, sometimes rapid, but which always point in the direction of integration. To call a halt is unthinkable because it would involve the risk of moving into reverse, and could rekindle in the minds of the Member States' citizens the illusion that going it alone was preferable to working together. I believe that the ECB would have difficulty in exercising its role efficiently if the integration process were halted. The ECB, like all central banks, needs to function within a stable institutional context that guarantees economic, social and political cohesion.

I now move on to the second challenge that the central bank must address in the coming years, namely the low level of growth in the economy. For five years now, forecasts of euro zone economic growth have been systematically revised downwards, while those of other regions, in particular the USA, have been revised upwards. For the last five years, the forecasts of the Monetary Fund, the OECD, the European Commission and the central bank itself have been proved wrong. The latest forecast of the European Commission for growth in the euro zone in 2005 has been revised downwards to 1.6%. Last October it stood at 2.1% and a year ago at 2.3%. Europe, and the euro zone in particular, is growing slowly, too slowly, and it is natural for many people to believe – and perhaps convenient for some to believe it – that this low growth rate is partly the fault of the European Central Bank and of the euro. The belief has become widespread, at least among a section of the population and even in that country which had adopted stability as its guiding principle, that there is perhaps too much stability and that a little of it could be sacrificed in the interests of higher growth.

In my written replies to the questionnaire, I indicated that the European Central Bank had a clear mandate, defined in the Treaty, to support economic growth in Europe, on condition that this did not threaten price stability. I believe that, in the last few years, the European Central Bank has operated in a manner consistent with that objective. Such low levels of interest rates in Europe, historically without precedent and actually negative in real terms, show that economic performance is a vital factor in political and monetary decision-making. If this were not the case, interest rates would not stand at 2% today but would instead be close to the historical average of around 5%, as in the UK. If rates are now 2% rather than 5%, this is because euro zone growth is not at its historical average of 3%, but is only marginally over 1.1%, and because there is a significant gap compared to the potential level of GDP. In my view, this shows that the ECB has

taken account – and continues to do so – of the economic cycle when setting its monetary policy. Despite the monetary stimulus, the growth rate is disappointing and the economic slowdown which appeared to be a cyclical phenomenon is instead proving to be a structural one. For this reason, action to relaunch growth must also be primarily structural in nature.

I now come to the third challenge, partly linked to the second: the achievement of a fully integrated internal market. Operating in a single flexible market is easier for a central bank, enabling it to act with greater determination to combat external shocks, and also allowing monetary stimuli to act in a uniform manner across all countries. I mentioned earlier that the greater rigidity in the European economy has slowed down action to reduce interest rates in Europe in recent years, when compared, for example, to the situation in the USA. After the implosion of the financial bubble at the end of 2000, the US economic slowdown was accompanied by an unprecedented increase in productivity, enabling labour unit costs and inflation to be reduced without a reduction in real earnings. That allowed the Federal Reserve to cut interest rates quickly. The flexibility of the financial market enabled companies and families to benefit from low interest rates as a way of increasing their own wealth, thereby underpinning consumption and investment.

In Europe this did not prove possible to the same extent, owing to the rigidity of the market for labour and goods, and to the still inadequate integration of financial markets. That was not all. The inadequate flexibility of European economies gave rise to variation in the impact of monetary policy from one country to another. It is therefore vital for the integration process to forge ahead in all markets, in order to produce benefits for the entire population. That is the only way to compete on an international level.

The European economy now represents around 30% of global GDP, or 22% if we only consider the euro zone. If current growth trends continue, by 2020 this share will have fallen by five percentage points and will continue to decline. For European companies, competition cannot be limited to the internal European market but must extend to the global economy. To prevent integration, to place obstacles in the way of integration of the European market, would not only mean hindering the smooth working of the European economy and of the economies of its Member States, but would also serve to inhibit the development of our ability to compete on a global scale.

There is no doubt that the processes of reform and economic and political integration are more difficult at a time of stagnation. In the past, Europe has resisted centrifugal forces, thanks to the strength of its institutions, the belief of its population in the common good, and, above all, the commitment of its leaders to forge ahead with the process of integration. The European institutions, in particular Parliament and the central bank, have a key role to play: they must work together to reinforce the progress achieved to date and to give the citizens confidence in the Union’s project. That is the goal to which I shall devote my energies in the coming years.

(Applause)

2-008

Cirino Pomicino (PPE-DE). – *(IT)* Madam President, I agree with everything Dr Bini Smaghi has said in his introduction, namely, that a central banker cannot be isolated from the context in which he operates. I do not go along with those who blame the European Central Bank for the economic slowdown. I am in favour of low interest rates, which demonstrate the European Central Bank’s understanding of the economic cycle and its needs, and I would add that we are experiencing a strong liquidity position, with sustained M3 growth.

Thus, if the monetary policy observed by the European Central Bank until now has taken on the burden of economic growth problems, the question is: why has the economy not taken off? Furthermore, given that within the Member States, some countries have sustained growth whilst others, such as Italy and Germany, do not, do you believe that demand policy must be emphasised, which would suggest reform of the Pact with flexibility in the deficit/GDP ratio? Or perhaps, in your opinion, is this not the time to tackle structural problems by means of a diverse and more incisive supply policy?

2-009

Bini Smaghi. – *(IT)* It seems to me that your question on why the economy is not taking off**,** why consumers are not consuming and why entrepreneurs are not investing relates to a problem present not only in Europe, but perhaps also worldwide. This can be seen in the latest data of recent days, according to which the US is also showing signs of a slowdown. I believe that the main reason – at least in Europe – is a lack of confidence in the future by consumers and entrepreneurs, despite extremely strong liquidity. Consequently, there is no strong incentive to incur debts in order to develop investment programmes or to increase consumption. I believe that the lack of confidence in the future is motivated by the fact that we are facing a series of challenges, particularly as regards the trend of government debt.

If we consider the ageing process of the European population and estimate the cost of European welfare, it becomes evident that the current system is unsustainable. Many citizens and entrepreneurs realise this, and are thus fearful of investing or consuming as they are afraid of having to then face up to an increase in the taxation system, that is to say, an increase in taxes, to finance a welfare system that is unsustainable.

I believe that the absence of reforms is an issue which primarily affects the largest countries of the EU – France, Germany and Italy – where estimates made by both the banks and the forecasting institutions effectively show that the various countries are facing 30 years of a worsening welfare burden. If such a trend is not remedied, I believe that these countries are faced with continued uncertainty and hence diminished confidence in the future on the part of their citizens. This affects both monetary policy and budgetary policy. Who will pay the debt that we are creating today if not future generations, who will already be burdened with a large debt?

I consider this to be the main issue, which demonstrates the present-day difficulty of acting by means of monetary and budgetary policies. It is therefore true that we must tackle such problems through supply policies and liberalisation of markets and, above all, by overcoming this uncertainty concerning the pension system and welfare which, I believe, weighs heavily upon the confidence of citizens today.

2-010

Radwan (PPE-DE). – *(DE)* Madam Chairman, I warmly welcome Mr Bini Smaghi to this House, and I have three short questions for him. Firstly, Mr Bini Smaghi, although you referred to the importance of Parliament's role, the fact is that we have no official right of codecision in the appointment of members of the ECB's Executive Board. We cannot exclude the possibility of our today voting to take a critical line, so what effect would it have on you personally if we did? I would ask you to keep your statement brief.

Moving on to the second question, I have read your answers with care. In them, you do not keep exactly to the line taken by the ECB, which has followed the German *Bundesbank* in being highly critical of what is termed the reform of the Stability and Growth Pact. You have found plenty of good things to say about it. In so doing, are you not setting yourself at odds with your future colleagues? More specifically, you said that the Board has ideas about how the Pact is in future to be interpreted. If you know what these ideas are, can you tell us about them? What is apparent to us so far is that even the 3% rule, which was intended to be rigorously applied, is being disregarded. As regards the interpretation of the Pact, what will the future tendency be?

On a related subject, my second question has to do with savings when the going is good. As the Commission has not been able, using the present Pact, to get its way in its dealings with the finance ministers, I would like you to tell me what instrument you think the Commission possesses for getting the Member States to make savings when things are going well for them. How will it be able to achieve this in future? I do not believe that the Commission has such means at its disposal; in this context, it has lost powers rather than gained them.

Thirdly, I assume, on the basis of your interpretation of the Stability and Growth Pact, that you are in favour of the budgetary policy that Italy has pursued over recent years. Do I understand you rightly in that?

2-011

Bini Smaghi. – The first question concerned the importance of Parliament's view in the confirmation procedure. I have respect for democratic procedures and my ideal is the US model, which I admire. It is very important that we follow the accountability procedures that are provided for in Europe.

Let me turn to your second question. My answer is not inconsistent with the ECB's view. The ECB view was given the day after the Ecofin Council met and consists of two short paragraphs. I wanted to give a more analytical answer. However, if you read my answer, you will see I made it very clear, first, that via the declaration annexed to the Constitution, the Heads of State requested a clarification of the pact, which was overdue. Second, the reform of the pact gives more room for economic analysis. This can only be welcomed. However, it will depend on how the analysis and discretion will be used. I also say that there is a risk that the new system might give some countries the idea that there is a lot of room for manoeuvre. This is not the case, because the reform of the pact states – in particular with respect to the 3%, as you mentioned – that only temporary and very small deviations can be tolerated. I see a risk there. This is consistent with what the ECB says.

My answer contained an exercise. I asked what would have happened if we had had this reform three or years ago, what would have changed in the life of the pact? It was an interesting exercise. It helped me at least to see whether we could give a good mark. There are a few incidences in which the new pact would have made life easier and would have ensured better discipline. An example is the famous case of November 2003 where the Council and the Commission could not agree on a procedural matter. The reform of the pact now clarifies this procedure. We can give a new recommendation to a country by starting again on Article 104(7).

I have not read the Bundesbank opinion, but I assume it is consistent with that of the ECB. I consider myself to be consistent with the ECB, so I should be consistent for the transitory property with the Bundesbank as well.

In answer to your third question, the Commission now has stronger powers, especially in the preventive arm. The problem with the previous pact was that in the good years of 1999 and 2000, countries such as Germany, Italy and France did not

make sufficient corrections in terms of budget discipline. Now the Commission has powers to put pressure on countries to make stronger adjustments in good times. That is a good thing.

2-012

Berès (PSE). – *(FR)* Mr Radwan, you have unfortunately run out of time. You will be able to ask another question if there is enough time left at the end of the hearing.

Mr Bini Smaghi, on behalf of the Socialist Group in the European Parliament, I should like to ask you a question relating to real inflation and perceived inflation. My reason for asking this is that, in your capacity as a member of the ECB's Executive Board, it will be your job to apply the Bank's Statute and thus to formulate a monetary policy that is governed by stability and prices.

Even though we know that stability has been achieved, we have on occasion been surprised to learn that many of our fellow citizens are convinced that inflation is occurring primarily as a result of the move away from their national currencies to the euro, yet also due to subsequent and persistent inflationary pressures. This is at any rate the public perception of inflation. We have begun to draw up a report on this issue, upon which our rapporteur, Mr Maaten, spoke yesterday, and we have also organised a debate on the matter.

While you are taking part in this discussion today, I would be interested to hear your analysis of the situation and your views on it, as well as the steps you believe should be taken to remedy it. In your opinion, does it mean that another monetary policy should or could be implemented?

2-013

Bini Smaghi. – *(FR)* If we had to conduct monetary policy in line with perceived inflation, we would have to be a great deal stricter, and this would not necessarily be a good thing. I believe that what we have seen is a problem of perception, and the extent of this phenomenon has in fact been investigated.

Studies carried out to date show that perceived inflation is higher than real inflation. This is a major problem, both in psychological terms and with regard to consumer confidence. It must be said that the authorities may well bear a certain amount of responsibility for causing the problem, as it is perhaps the case that they have contributed more than they should towards this difference in perception. If real inflation were in fact equivalent to perceived inflation, which stands at around 6% in certain countries, consumption would have dropped dramatically, and we would not have zero growth or 1% growth, but a recession. This is not what has happened, however.

There is therefore no correlation between real inflation and perceived inflation. In view of this fact, I believe that we must be seen to be credible and that we must stand up for the institutions in charge of measuring inflation. In my opinion, public uncertainty should not be increased. We are now seeing the first scientific studies on this issue, and indeed before today's hearing I read a study by the Bank of Italy on real inflation in Italy at the time of the changeover to the euro. The study, which will be published shortly, gives a very detailed analysis of the situation.

It is apparent that price increases did occur in certain sectors – these are referred to as price increases, rather than inflation – and that they occurred more frequently during certain periods and in certain sectors, making it appear that inflation was a great deal higher than it was. Yet the conclusions to these studies make no mention of the fact that real inflation has a meaning other than that contained in the figures from the bodies responsible for providing statistical information.

The reason why this is a major problem is that it is also a political problem, yet although public perception is becoming a political problem, it is a problem that must be tackled in a responsible way. The public must be told that price stability has been guaranteed over the past few years and that the Central Bank has ensured that this is the case, and it must be told that purchasing power has been protected. We must prove that we act responsibly, obviously on the basis of serious studies, because we do not want to turn anyone into a laughing stock.

Serious studies must be used to demonstrate that after all these changes had taken place, and in spite of all the concerns people had, macro-economic stability was achieved. We must instil fresh confidence in the public.

2-014

Sánchez Presedo (PSE). – *(ES)* Mr Bini Smaghi, I would like to begin by thanking you for being here.

You will of course be in your post for eight years, and during that time there is no question that many things are going to happen, on both the international and the European scenes.

The truth is that the essential function of the Central Bank is price stability, but it must also contribute to growth. You have said that you like the American model, although it cannot be applied strictly in the European Union, because here we could not do what, for example, President Bush has done: reduce taxes and increase public spending when it is considered necessary to reactivate the economy. The Central Bank therefore perhaps has greater responsibility in terms of contributing

to growth, because our capacity for action at Union level is completely different to the capacity of the United States in terms of federal policy.

In reality, external demand, from the United States, is weakened as a result of fiscal and commercial imbalance and the fall in saving. The depreciation of the dollar is a consequence of this and, if there is to be growth, what we fundamentally need is a reactivation of internal demand.

You have said that one of the fundamental issues is mobilising saving and, in this field, it is clear that there is, on the one hand, private saving and, on the other, public saving, and that they should perhaps be treated jointly.

You have also talked about precautionary saving. How do you believe the European Central Bank could contribute in practice to mobilising saving and truly make it a dynamic element that stimulates demand and the economy in the Union?

2-015

Bini Smaghi.– *(IT)* I should like to make it clear that whilst I value the US institutional model, I do not necessarily value the policies carried out in the US. Your question is clearly important and concerns the main challenge, that is to say, how to make European citizens save less and consume more.

The immediate and, perhaps, standard response is that the best way is to ensure stability of purchasing power and low inflation, and to convince citizens that there is low inflation. This is a message that we must convey more clearly and convincingly. I believe that the European Central Bank should help to explain to citizens that, despite the current risks and problems – despite the oil shock, for instance – inflation is at 2% or below 2%.

If a comparison is made with historical experience, this fact is rather exceptional. Moreover, we have very low interest rates and this ought to encourage citizens to spend more. I maintain that the chief contribution of the European Central Bank is to implement not only a monetary policy, but also a communication policy which gives citizens confidence. I believe that the rest must also come from additional policies, both structural and budgetary.

With regard to budgetary policy, you have rightly pointed out that we cannot implement the same policy as the US, because if we reduce taxation as in the US, the dynamics of European public finance will, without doubt, become more unstable. There is a structural problem of reduction and adjustment of public finances in Europe, and the dynamics of public spending are unsustainable and must be brought under control.

I believe that citizens are conscious of the fact that a little more debt today means more problems in the future, and that does not give them confidence. We must therefore confront the challenge of encouraging citizens to have greater confidence and to spend more. The greatest contribution of the European Central Bank is to guarantee low inflation and to reassure citizens that inflation is genuinely under control.

2-016

Klinz (ALDE). – *(DE)* Madam Chairman, Mr Bini Smaghi, you said that the European Central Bank has to have a safe institutional environment in which to operate. Creating and guaranteeing such an environment is not the least of the objectives of the European Constitutional Treaty, which is currently in the process of being ratified. In some countries – France for example – that will be done by means of a referendum. The outcome of a referendum is always uncertain. What seems at present to be happening in France is something that was unthinkable only a few months ago, in that it seems possible that a majority will declare themselves opposed to the Constitutional Treaty. There is already speculation in the media as to what that might mean for the Euro and for the eurozone.

I would be interested to know what effects you would expect a ‘no’ in the French referendum to have on the Euro and the eurozone, and how you would advise the European Central Bank to respond in such a situation.

2-017

Bini Smaghi. – *(IT)* In my introduction, I touched upon one of these issues, namely the need for a central bank to operate in a secure institutional set-up. I maintain that the European set-up can only be secure if it progresses.

The problem of ratification of the Constitution, particularly in countries where a referendum is being held, is that, *ex ante*, perhaps every participant in the referendum is aware of the reason why they are voting yes or no. In particular, there are citizens who vote no because they are against integration, whereas others vote no because they would like greater integration. Nevertheless, *ex post*, a no victory is a victory against integration, and so I fear that those who vote against the Constitution because they want greater integration will end up swamped by those against integration. I would therefore call for a yes vote from those who would have wished for greater integration and a more robust Constitution. A no victory would be a victory against integration, and that would undoubtedly cause problems at the European Central Bank, because it would create a process of uncertainty.

The markets are already studying that prospect and are calculating the type of volatility there would be on the markets. Some believe that interest rates could rise and that the spread among interest rates in the various countries would increase, because the danger of an integration process moving in reverse would weaken the European Commission and the Stability Pact agreement. Very uncertain mechanisms would be created, which could provoke a series of problems.

The Treaty of Nice, with all of its problems in terms of decision-making mechanisms and so forth, remains in force at present. Accordingly, the European Central Bank must assume its own responsibilities and continue to ensure monetary stability. This does not, however, preclude the task from becoming more difficult. I am unable to predict at present the concrete actions of the European Central Bank, but I believe that it will without doubt have a more difficult task, and will have to clearly state its determination to achieve stability.

2-018

Hassi (Verts/ALE). – *(FI)* Thank you, Mr Smaghi, for coming here and allowing us to ask you some questions.

You have said of the reform of the Stability and Growth Pact that it will create uncertainty as to how certain essential factors will be taken into account when estimating excess budgetary deficits. What, in your opinion, is the right way to take account of these essential factors? You also speak of the structural reforms that are needed. What exactly do you mean by necessary structural reforms? Moreover, what action are you prepared to take to promote qualitative growth in Europe in support of the Lisbon objectives? Do you, for example, support public funding for the investment that is needed to achieve the aims of the Kyoto Protocol?

2-019

Bini Smaghi. – I shall go back a few years. What happened after 2000? Most of us, even the Commission and other forecasters, thought that the slowdown in the economy would be temporary, that the economy would pick up and, as I have said, year after year revisions have been downwards. So the strategy in public finance, particularly in Italy, Germany and France, was to gain time. Let us increase the deficit and we will adjust when growth comes.

In France and Germany this was done by higher deficit, in Italy it was done through one-off measures and temporary adjustments. The only thing is that, year after year, growth did not pick up. Now, five years on, growth is low and we need to adjust public finances with low growth. In the case of Italy, no one-off measures are possible, and France and Germany need to adjust because in the last five years the debt as a percentage of GDP has increased by ten percentage points.

The situation is that growth is much lower than we thought it would be and it is going to be lower over the next few years than we all thought. So there is a need to reduce deficits because the current borrowing, which leads to higher debt, is going to put a burden on future generations – or five or ten years from now – when the situation is going to be even worse. My assessment of budgetary policies would be that they have a difficult task now because they have to adjust. The authorities hoped that the adjustment would take place with higher growth. Now growth is lower, but the adjustment needs to take place. It is essential that it take place because it is not sustainable.

As regards the Lisbon Agenda and how to incorporate it into the reform of the Stability and Growth Pact, some of the elements are in the pact. One of the most interesting things in relation to the pact would be to take future debt dynamics into account so as to create incentives for countries to adopt structural reforms that would improve the sustainability of their debt. I have in mind, for instance, the case of Austria, which last year implemented a very important pension reform. Thanks to this pension reform, which has stabilised the debt-to-GDP ratio, Austria could gain some room to manoeuvre, so the deficit could oscillate a bit higher than equilibrium in compensation for the strong pension reform. These are the kinds of incentives that the pact can give within the normal ranges that have been agreed.

2-020

Wagenknecht (GUE/NGL). – *(DE)* Madam Chairman, my first question also has to do with interest rate policy, and more specifically with situations in which it is not clear what decision should be taken.

I wanted to ask you what your priorities would be in – for example – a situation like the one we are in at present, to which you have already made reference, one that is characterised by extremely low growth, high unemployment and – despite relatively high oil prices – relatively low inflation all round. It is nevertheless possible that the overall level of inflation could rise in response to certain knock-on effects of inflation, imported, for example, through the energy markets. Weighing up the priorities in such a situation, would you say – or, within the European Central Bank, find yourself on the side of those who say – that a rise in interest rates is called for, even if it results in even more unemployment, throttles investments, reduces consumer demand and, in one way or another, signals a rise in inflation? Or would you, when weighing up those priorities, say that the ECB's primary responsibility is to safeguard growth and employment?

My second question has to do with another problem that is frequently discussed. Let us assume that there are no inflationary tendencies on the commodity markets, but instead indications of them only on certain financial markets – in other words, that there are bubbles. Do you regard interest rate policy as a suitable means of dealing with such situations, or do you think that bubbles of this kind should be combated by other instruments, particularly in a low-growth situation?

2-021

Bini Smaghi. – I have elaborated a bit more on your question in my written answer. It is important to realise that monetary policy affects income and prices with a 9- to 16-month lag. When you decide your interest rate policy, you have to look ahead at the impact that this policy will have. You need a model to forecast inflation. You have to be careful, because when inflation comes down you might think you have room for manoeuvre to reduce interest rates, but of course there is a limit to that and you have to be careful that you do not reduce interest rates to the point where inflation starts picking up again. When you look at what has happened over the last few years, interest rates have come down to a record low of 2%, which is basically negative or zero real interest rates.

The question is, should we reduce interest rates even more? What would the impact of a further cut in interest rates be? If you simulate a further reduction in interest rates and you look at the forecast, you will probably have a result of an inflation which will go above 2%. Inflation is now projected to be a little less than 2%, so you cannot push interest rates too low. You have to push them up to a point at which if you forecast inflation you have a forecast which is still below 2% and I think that is what has happened.

Over the last few years there was room to reduce interest rates and this has helped growth, but of course we could not reduce interest rates as they have in the US. In the US, interest rates were cut to 1%, but inflation there was 1% at a certain point: much lower than in Europe. This is why, in my view, the Federal Reserve and the ECB did not act very differently if you compare the dynamic of inflation.

In answer to your question, the task of monetary policy is to help growth, but only to the extent that it does not push inflation up above the 2% level. I think there is enough room for manoeuvre there.

Although it should not be a target, inflation in assets is a good indicator that maybe you are pushing interest rates too low. The situation we have in Europe now may suggest that interest rates are relatively low. If you keep them so low and the economy picks up, we might have the risk of a bubble and this is the risk they are running very seriously in the US.

2-022

Martin, Hans-Peter (NI). – *(DE)* Madam Chairman, I found Mr Bini Smaghi’s response to Mr Klinz’s question and to the problem he raised on behalf of the Liberals very interesting and illuminating. I really do think there is a fundamental problem here, in that those who argue against the European Constitution run the risk of getting less than they might do. There is, though, something I would like to add.

Mr Bini Smaghi, do you, from where you sit at present – or, if you like, in terms of what you would recommend to the ECB – think there are real prospects here? What can one offer as a prospect to those who argue with good reason against the Constitution, because they want more integration, particularly in relation to economic policy and to the ECB, to make it easier for them to say ‘yes’, especially if we argue on the basis of the old fundamental antithesis between price stability on the one hand and economic growth and impetus on the other?

2-023

Bini Smaghi. – I do not know if I should be drawn into national debates on whether to vote ‘yes’ or ‘no’ to the Constitution. I am tempted, because I hope it will be adopted. As I said, I respect those who are tempted to vote against the Constitution because they would have liked more from it. I too would have liked more.

However, if the ‘no’ votes win, there will be no room for this opinion, because nobody will be able to distinguish between the ‘no’ votes against integration and the ‘no’ votes in favour of more integration. It will be a victory for the ‘no’ votes against integration.

This is the argument I would use: *ex ante*, you may be right, but *ex post* you will be wrong. I am being blunt in saying this. These are my personal thoughts. I see a big risk. Therefore, an idea which is respectful *ex ante* may be devastating *ex post*. It is a big responsibility. Over the last 50 years, Europe has been built step by step. Some people would have liked the pace to have been faster, others slower, but the important thing is to make progress. If the Constitution is not adopted, the temptation to go backwards will be very strong.

2-024

President. – This issue clearly goes beyond the scope of the Monetary Dialogue and the remit of a candidate to the ECB’s Executive Board.

We will now move on to our second group of speakers. In order to ensure that we have time for all the questions, I propose that speaking times be reduced to one minute for questions and two minutes for answers. In my opinion, what matters is that everyone gets a chance to state their views.

I shall begin by giving the floor to our Vice-Chairman, Mr John Purvis, for one minute.

2-025

Purvis (PPE-DE), *Vice-Chairman of the Committee on Economic and Monetary Affairs*. **–** Welcome, Mr Bini Smaghi. In your written response about the Stability and Growth Pact, you say that the reform will give rise to some uncertainty on how relevant factors will be taken into consideration in the assessment of an excessive budget deficit. Some – and I suspect you have a country you know rather well in mind – may be led to believe that significantly larger budget deficits will now be tolerated, and they will act accordingly. I suspect that you are probably right, and that there will be a resort to borrowing, rather than taxing or reforming. I wonder, if the Commission turns out to be rather less effective than we would hope in policing the Stability and Growth Pact, what would be the role of the ECB? The Member States can no longer print money. Would you expect interest rates in the various Member States to differ substantially and, if the chips really were down, would you allow an Orange County solution, a bankruptcy of a Member State?

2-026
Bini Smaghi. – Mr Purvis, you raised many interesting questions. On the bankruptcy issue, the Treaty prevents any country or the Union from coming to the rescue of a bankrupt country, so in theory that would apply. Interest rates have already reacted. If you look at the markets, spreads have already moved, and I hope that those countries where interest rates have increased will realise that this is a signal that markets are looking very closely. In addition to the pact, there is market discipline. Market discipline sends signals and I hope that the signals will be noticed.

The uncertainty is there. The day after the reform of the pact there were statements in the newspapers saying ‘now we can do whatever we want’. Fortunately, things have changed since then. Rules are still in place. It is important that these rules be implemented, along with all the requests for economic analysis that the pact the asks Commission to carry out. I think the procedure remains quite clear, so I am confident that despite all the uncertainties, the pact will continue to promote budgetary discipline.

2-027
Hökmark (PPE-DE). – I too would like to ask you about your written answer on the Stability and Growth Pact. When you elaborate on the examples, you say that the new proposal would have given a greater opportunity to the Commission and the Council to put pressure on the German, French and Italian governments in better times. Do you really believe that the budget policy in these countries would have been different under the new rules during this time? At the same time, the budget rules of the new proposal would also apply for paying increased attention to the difficult problems of each country. Is it really your belief that we would have seen another budgetary development with the new rules? Also, do you think that the newly proposed rules would be better able than the old rules to handle the situation in Italy, France and Germany?

2-028
Bini Smaghi. – The change of the rule that I mentioned applies to the good times. Therefore, in good times the kind of difficulty that you mentioned is less prevalent. For instance, in France, 2000 was the year of the *cagnotte*; in Italy there were strong incentives to cut taxes because of various factors; in Germany there was a tax reform. There was no pressure from the Commission because the instruments and tools allowing for an adjustment of the calculation of the deficit to take into account the ‘cyclically adjusted’ deficit were not available. If you look at these measures now, you see that in 2000, for instance, which was a good year, budgetary policy was expansionary: the cyclically adjusted budget deficit increased, which is quite surprising, because the opposite should have happened.

Now we have the instruments and the Commission is asked to do it. Therefore, I would expect the Commission to raise a finger and, via the surveillance exercise, to mention to countries to adjust more in good times. There is the possibility of early warnings. The instruments are there and I expect them to be used.

2-029
Konrad (PPE-DE). – *(DE)* Madam Chairman, I would like to address two important points, which, although they ultimately have to do with the relationship between the European Union and the European Central Bank, should also be considered in connection with the Constitution.

One of these issues could be summed up under the heading of ‘economic policy coordination’. Although this is, of course, something for the eurozone to do, I believe that we should view it in a critical light. If there is too much coordination, for example in the case of European employment policy, it can have adverse effects. We do indeed also need competition in Europe – between states and between the policies put forward in one or other Member State.

The same is also true where fiscal autonomy in Europe is concerned. It is my conviction that tax competition enhances Europe as a business location. Where do you stand on this? I think there are plenty of people in this House, and in particular those from the countries where taxes are very high, who would very much welcome harmonisation in this area. The question therefore arises of whether tax competition might not do some good in terms of attracting businesses. I would, of course, be particularly interested to hear what you have to say about this.

2-030
Bini Smaghi. – Sometimes central bankers are drawn to answering questions that are not directly within their remits. I was drawn into the issue of the Constitution and I answered the question because I felt it was my personal commitment as a European citizen to do so.

Tax competition is one of those issues where there are pros and cons. As an economist, I would say that when you live in an area where there is a lot of integration and you have very mobile factors, then you have to be very sensitive to avoid distortions and to avoid competition leading to excessively low rates of taxation. That would create externalities, so personally I am in favour of setting ‘floors’ to such competition. This does not mean that you have to harmonise everything, but again this is more a responsibility for those of you in this room. Monetary policy can operate well with competition, or with harmonisation.

2-031

Bullmann (PSE). – *(DE)* Madam Chairman, Mr Bini Smaghi, mention has been made of the way in which, in major EU Member States, people are saving more, even though financial resources are urgently needed to stimulate more private consumer spending and more investment. In your written answers, you refer to this being primarily to do with people’s expectations of income.

Are we not, though, sending out conflicting messages? On the one hand, we want people in the lower and middle income brackets to invest more in their old age provision, which means saving more, while, on the other hand, we want them to consume more. Is it not possible that we are demanding too much of them? And is it then not perhaps incumbent upon us to make it a core European policy objective to stabilise the incomes of the lower and middle income brackets and also to demand of the Member States a coordinated policy of full employment? If we do not, the countries of the eurozone could grow too far away from each other, with larger economies enfeebled and smaller economies booming, so that the ECB’s monetary policy would cease to be effective, because it would be trying to deal with wholly divergent economic conditions.

2-032

Bini Smaghi. – The dilemma is between saving more or consuming more and therefore the challenge to Europe is to work more or to have more people working. This means more employment and more productive employment.

It would be ideal to have a way of stabilising income levels, but how do you achieve this? That is the difficult question. How do you achieve this in a world where competition is constantly increasing? The only way to achieve this is by investing and increasing productivity and being able to compete. For instance, Germany has been very effective in being able to compete with the rest of the world, but this has led to less and less employment. The challenge is to be able to compete and increase employment. The opposite applies to Italy: it has increased employment but has lost competitiveness. The challenge for Europe is to do both. With globalisation, where you have competition from new countries that want to get a piece of the wealth and that are willing to work more, this is more and more difficult.

For consumers to increase consumption requires more security in terms of the welfare system. That does not necessarily require more savings, but perhaps a longer working life. Perhaps we need to reform the welfare system and work longer. That is inevitable. In return for that, at least you have security in terms of your welfare system and retirement plan, and therefore you do not need to save more than is required. Europe is saving more than necessary because of uncertainty.

2-033

Letta (ALDE). – *(IT)* I have found your replies on the subject of the role of the European Central Bank, on growth and on the Stability Pact to be very persuasive. I also believe that you have explained in a very clear and important manner the positive aspects of the Stability Pact agreement, namely the fact that the new Stability Pact does not allow for more flexible and buoyant budgetary policies for either the deficit or the debt. With regard to the answer you gave to Mr Klinz on the French referendum, I should like to ask you to what extent a possible increase in interest rates would have a negative impact, particularly on countries with a large government debt. I am, of course, referring primarily to Italy.

Secondly, I should like to address an issue which has not been touched upon until now, namely the enlargement of the euro zone, which you mentioned in one of your answers. In this regard, I should like to ask you what you think about the future stages, what possible timetable you envisage and how important you think it is for the pound sterling to join the euro zone in the short-term.

2-034

Bini Smaghi. – *(IT)* I shall begin with the last subject mentioned. With regard to the enlargement of the euro zone, we have three countries – four if we count Denmark, where there is an issue of willingness – which already belong to the European Monetary System 2. I believe that another three countries will enter shortly, as a result of which we shall have six countries on the approach to the euro zone. I think that, before this decade ends, some of these countries will have already joined the euro zone. This will, of course, pose a series of problems, in terms of convergence and also acceptance of the changeover to the euro, which will be more effectively managed than in our country.

The presence of the pound sterling in the euro zone would without doubt significantly increase the euro’s potential to become a genuine alternative to the dollar. That, nonetheless, creates a series of problems of a more political than economic nature, because the integration between the United Kingdom and the euro zone is now extremely strong. Suffice

it to say that the main trading partner for the euro zone is not the United States, but rather the United Kingdom, as a result of which there is extremely robust integration between the United Kingdom and the euro zone.

As regards the effect of the referendums on taxes, it is extremely difficult to estimate how the market will react, but it will undoubtedly work to the disadvantage of the most indebted countries. Italy is certainly the country that could suffer most as a result of the French referendum, as was the case in 1992, when the referendum resulted in the lira leaving the EMS. Let us hope that this analogy is not repeated.

2-035
Radwan (PPE-DE). – *(DE)* Madam Chairman, I would like to just briefly sum up my understanding of Mr Bini Smaghi's answers to my questions. As regards Parliament's role, Mr Bini Smaghi, you said that you are interested in it, but that it is certainly not of any consequence over and above that.

On Italian and German debt – I asked you particularly about Italy's deficit – my understanding is that you said that these countries' budgetary policy in recent years was correct as regards reform of the Stability Pact.

I really did not understand your answer to my third question at all. Why is it that you believe that the Commission will, in future times of prosperity, be better able to enforce its will on the Council? Could you perhaps explain that again? In no way whatever would the Commission be in a stronger position, and I do not so far see any possibility of the Commission compelling the Council, against its will and in the teeth of resistance from it, to make savings when the economy is on the up. I would be interested to learn what your evidence is for that.

2-036
Bini Smaghi. – Regarding Parliament's role in appointments to the ECB, there are different traditions. It is not a tradition in Germany, for instance, for a person to be appointed to the Bundesbank to appear before the German Parliament. Nor is it the case in Italy. In Europe there is. I think it is very good because it is part of the accountability process. It was based on the American model. I think it is very good to have a similar mechanism. This procedure is different from the national one, but improves accountability.

On the relationship with the Commission and the Council, if you look at the reform of the pact, I do not see any element in which the Commission is weakened or distanced from its prerogatives. I do not think that you will find on any page of the report any element which weakens the Commission. I would perhaps ask you to give me an example of that.

2-037
Radwan (PPE-DE). – *(DE)* Madam Chairman, I asked how, in times of prosperity, the Commission can compel the Member States to make savings. How is it to do that in future if the rules remain unchanged and the Council – as we have already seen it do – disregards the Commission's rulings?

2-038
Bini Smaghi. – The reform of the pact has not changed the Treaty. The Treaty remains unchanged. The Council decides on a proposal from the Commission. The Council can vote against the Commission, as it has done in the past and may still do in the future. Perhaps we need more time here, but it was not the intention of this reform to change the Treaty. It would have been unacceptable and Parliament, which has to give an opinion, would not have accepted this.

The new pact contains more instruments to put pressure on countries. An early-warning system is being designed for the Commission, and that is something new. This early warning has to go to the Council, which can vote against it. That remains unchanged.

2-039
President. – Mr Radwan, you have spoken for a great deal longer than planned, but I did not interrupt you as you had not asked your question on Italy again.

I notice that Mr Bini Smaghi has just confirmed that the balance of the draft Constitutional Treaty as it stands does not make it possible in any way to move forward on these issues relating to economic governance and to the strengthening of the Commission's powers. You appear to wish that this was the case, and I believe that we agree on this point.

The final speaker will be Mr Rosati, who will have one minute to speak on behalf of the Socialist Group in the European Parliament.

2-040
Rosati (PSE). – Mr Bini Smaghi, I would like to ask you three short questions. The first is on the monetary role played by the European Central Bank. It is based on two pillars and three developments plus all the other relevant information. How do you rate this? How do you assess this approach? Financial markets are not always very clear about the preferences or weights attached to these two pillars, and sometimes it is difficult simply to explain the decisions of the European Central Bank.

The second question is on the appreciation of the euro over the last year and its impact on the overall level of restrictiveness of monetary policy. We have had the same level of interest rates, but an appreciating currency. Do you not think that there has perhaps been an indication to adjust the level of interest in order to maintain the level of restrictiveness more or less at the same level?

The third question concerns the requirements that will apply to the new Member States which sooner or later have to join the euro area. Amongst other things they are supposed to meet the so-called convergence criteria, one of these being the inflation criterion which is based on the reference value as an average for three Member States. What do you think of this? It does not make sense to make an average of three Member States within the monetary union in which you have only one monetary policy.

2-041

Bini Smaghi. – On the last point, a solution to this problem has been found within the convergence criteria. You make an interesting point about euro appreciation. There is no mechanical relationship between the euro exchange rate and monetary policy, otherwise we would have a monetary policy based on the exchange rate, which would not be good for Europe. By the way, interest rates would have had to increase in the last few days, so it is not necessarily good. The point is that the exchange rate of the euro is one element in forecasting inflation. *If* the only thing to change is the exchange rate, this would certainly reduce inflation: we have to see by how much and what the dynamics of this are. This could, therefore, have an impact on the restrictiveness of monetary policy. The only thing is that the exchange rate is not the only thing that changes: other things change, such as oil prices, productivity, etc. This is why interest rates and exchange rates do not move together.

In addition, one year ago it was anticipated that interest rates in the euro area would increase earlier this year. They have not. This is the one way to answer your question. In fact, monetary policy has also looked at the interest rates. The two-pillar strategy is useful because we in the euro area do not have inflation targeting. There are many variables to be considered, especially as we are at the very beginning of the euro's existence. There is no way to forecast inflation and growth very precisely, so we need another indicator like money, which traditionally has been important in forecasting inflation. Thus, at the end of the day, the markets now understand that these two pillars exist. One is seen as being more important than the other, and this has been revised in the revision of the strategy by the ECB. In the end the markets understand how monetary policy is being decided.

2-042

President. – I should like to thank Mr Bini Smaghi for having answered our questions. We will continue our meeting for ten minutes or so in camera, in order to discuss your performance. The meeting will then continue in public, and we will set out our views on your candidacy and take a vote. I would thank you for having participated in this hearing, and I may see you again soon.

(Applause for Mr Bini Smaghi and to mark the end of the hearing)

(The sitting was suspended briefly)

2-044

Vote on the appointment of Mr Bini Smaghi

2-045

President. – We can now continue our meeting in public. We have held our discussions in camera, and the gist of these will be outlined in the explanatory statement of the report I will present on your behalf to Parliament. We can now confirm that we reached a favourable conclusion on Mr Bini Smaghi's candidacy. Although he failed to answer all our questions, he showed himself to be firmly, but realistically, pro-European. He also demonstrated an obvious understanding of political issues and the ability to perform the duties of a member of the Executive Board. He showed himself to be open-minded towards Monetary Dialogue, and demonstrated both his respect for the European Parliament as an institution and the ability to view issues from a multidisciplinary viewpoint, something which can be attributed to his background and his career.

I would therefore propose that the members of the committee vote upon the resolution, which will be very formal. The first paragraph will state that we are in favour of the appointment of Mr Lorenzo Bini Smaghi as a member of the European Central Bank's Executive Board, and the second paragraph will call on the President of the European Parliament to inform the President-in-Office of the Council and the governments of the Member States that we support this proposal.

I should like to put this resolution to the vote. The appointment of Mr Bini Smaghi has been approved by 16 votes in favour, 2 votes against and 1 abstention. I should like to thank all those present and to remind you that we will meet again on 25 April for a public meeting with representatives of the national parliaments. I hope that as many of you as possible will be present.

(The sitting was closed at 12.45 p.m.)