Answers provided by Vítor Constâncio to the questionnaire drawn up by the Committee on Economic and Monetary Affairs of the European Parliament

A. Personal and professional background

Q1. Please highlight the main aspects of your professional experience in monetary, financial and business matters.

My experience in the mentioned matters is related with the positions I held as central banker, professor of economics and private banker. As you could see in my curriculum description I taught several economic courses during many years and, in particular, from 1989 to 2000 I have been Professor of Economics at Instituto Superior de Economia e Gestão (Technical University of Lisbon), as Coordinator of the Master's Degree on Monetary and Financial Economics and teaching Macroeconomics and Monetary Theory and Policy. Since 2000 until the present day I have only taught a semester course on Monetary Policy.

From 1995 to the beginning of 2000, I have been Member of the Board (Executive Director) of Banco Português de Investimento (BPI), a leading private portuguese banking group, with responsibility for Budget, Accounting and Control of Financial Market Risks. This experience provided me with a valuable practical knowledge of banking activity in general, with particular emphasis on accounting and risk management, knowledge which I consider very important for my responsibilities as a central banker. Representing BPI I have been also non-executive member of the board of PT, the Portuguese Telecommunications Company, and subsequently as non-executive member of the Board of EDP, the Portuguese Electricity Company.

The more relevant work experience in the present context has been, nevertheless, the positions I held in central banking throughout my professional career. I started in Banco de Portugal as head of the Research Department and afterwards, for a number of years, I was Deputy Governor and in 1985-1986 I held the position of Governor. I was appointed again Governor in the year 2000 and reappointed in 2006 for a new mandate of five ears. As a consequence, in the last ten years I have been a member of both the General Council and the Governing Council of the European Central Bank.

Q2. Please highlight the main aspects of your European and international professional experience.

In 1975- 1977 I was three times head of the Portuguese Delegation to the OECD examination of the Portuguese economy in view to the publication of the country survey. In 1977 and again in 1979, I was President of the Commission for European Integration, in charge of the membership negotiations of Portugal with the European Economic Community. In 1985-86 (in 1985 as an observer) I was a member of the Committee of Governors of the European Community Central Banks. In 1989-1992 I participated or headed economic missions for the IFC-World Bank in Poland, Czech Republic and Angola.

Since March 2000 I have been a member both of the General Council and Governing Council of the European Central Bank.

Q3. What are the most important decisions to which you have been party in your professional life?

As Finance Minister in 1978 I had to decide the policies to face a balance of payments crisis that the country was facing since 1976. The preparation of the budget and the complex negotiations of a standby agreement with the IMF, with difficult choices about interest rates (then the responsibility of the Government) and the exchange rate, implied demanding decisions that produced positive results: the external deficit was cut in half and the successful adjustment of the Portuguese economy.

As Governor of the Central Bank I implemented in 1985-6 a deep reform of the Portuguese money and forex markets paving the way for a more market-oriented method of conducting monetary policy. Interest rates were liberalized, a new Treasury-Bill market was created and managed by Banco de Portugal, certificates of central bank debt were created and a true foreign exchange market was formed with a daily fixing. At the same time the opening of the banking sector to private and foreign banks was implemented. These reforms helped the preparation of the country to conduct its policies in a more compatible way with full EEC membership that occurred January 86.

B. Monetary and economic policy

Q4. What would be the guiding objectives you will pursue during your eight-year mandate as Vice-President of the European Central Bank?

As Vice-President of the ECB, I shall be guided by the same principles as in my function as the Governor of the Banco de Portugal: respect for the legal aspects of the mandate, independence from political or other bodies, transparency and highest standards of ethical conduct.

I will fully respect the Treaty mandate. I am committed to the ECB’s primary objective of price stability and the principle of central bank independence. Without prejudice to the primary goal of price stability, I am also committed to the secondary objective defined by the Treaty of supporting the general economic policies in the Union with a view to contributing to the achievement of its objectives. Together with my colleagues in the Governing Council of the ECB, we will continue to do our utmost in order to deliver price stability over the medium term to the benefit of all European citizens.

Q5. What is your assessment of the monetary policy as it has been implemented by the ESCB for eleven years? What changes, if any, would you promote when becoming ECB Vice-President?

The introduction of the euro in 1999 was a historical event in monetary history. I had the honour to participate in the euro process as member of the Governing Council of the ECB for the last 10 years. I believe that monetary policy has been able to live up to the Treaty's objective, as reflected in an average inflation of just 2% since the beginning of monetary union and the firm anchoring of inflation expectations, a fundamental criterion of a good monetary policy. The commitment to keep inflation, on a medium-term basis, below but close to 2% is what provides the most solid structure to our monetary policy strategy. It is our compass, as President Trichet likes to point out.

More than a decade has passed since the start of monetary union. The ECB therefore still is a very young institution, compared to other European institutions and to other major central banks. One easily forgets the challenges that the ECB faced when it started conducting monetary policy for the euro area, with many uncertainties prevailing. The fact that these hurdles have been overcome smoothly, and that the ECB is a fully-fledged Union institution and a respected member of the international community of central banks already indicates that monetary policy in the euro area has developed very satisfactorily and therefore in my view does not require significant changes. Let me mention a few other facts that support my assessment.

The anchoring of inflation expectations around levels consistent with the ECB's definition of price stability in my view provides a clear signal that financial markets and the public at large attach great credibility to the single monetary policy being able to achieve its goal. The fact that inflation expectations remained fairly stable even in the financial crisis, when some were predicting a period of deflation, and when inflation rates temporarily turned negative, can be seen as an essential proof of the credibility of ECB's monetary policy.

The timely and bold reaction of the ECB when the financial turmoil erupted and when it turned into a full-blown crisis is another example of how successful the ECB monetary policy has been. The reduction of policy interest rates to very low levels and the introduction of various non-standard measures have proven the ECB's capacity to act quickly if needed. Together with governments' support measures for the financial sector and the fiscal stimulus measures adopted in the context of the European Economic Recovery Plan of end-2008, monetary policy has helped avoiding that things turned even worse.

All these facts prove that both the strategy and the framework for implementing monetary policy has been well designed. In this regard, I attach great importance to the clarifying statement we issued in May 2003 after having deeply analyzed the functioning of our monetary framework, an endeavour in which I actively participated. I want to stress five points of that statement. First, the new quantified objective for price stability, defined as inflation «below but close to 2%» that provides a sufficient safety margin to guard against the risks of deflation while at the same time addressing the issue of the possible presence of a measurement bias in the HICP and the implications of inflation differentials within the euro area.

The second point is related to the clear assignment of different time frames to the previous two pillars and to deal first in our communication with the economic analysis that is very relevant for the operational horizon of policy. The third aspect points to monetary analysis being very relevant for medium to long-term trends in inflation, specifically mentioning that «monetary analysis mainly serves as a means of cross-checking, from a medium to long-term perspective, the short to medium-term indications coming from economic analysis». The fourth item results from the intention to underline the medium to long-term horizon of monetary analysis and led us to decide that we would « no longer conduct a review of the reference value on an annual basis». Finally, the last point relates to the concept that « monetary analysis will take into account developments in a wide range of monetary indicators including M3, its components and counterparts, notably credit». If carefully reflected upon, these several points put into proper perspective the role of the different aspects of the comprehensive, full information analysis that we apply to assessing inflation risks.

Nevertheless, the scale and depth of the recent financial crisis calls for a reflection on the way policy is conducted at several levels, including the monetary area. In particular, the crisis brought to the forefront issues relating to financial factors, systemic risk and financial stability. The traditional thinking that price stability in the market of goods and services also provides the environment that ensures financial stability has been invalidated by the events of the past few years that show a succession of bubbles in asset prices coexisting with a regime of low inflation. While the instruments of regulation and prudential supervision are prominent to deal with financial stability issues, the disruptive effects of asset price booms and crashes, as we have seen in the present crisis, have reignited the debate about the consideration of asset prices in the conduct of monetary policy and also about the role of credit aggregates. We undertook the evaluation of the monetary strategy that I mentioned before, five years after the beginning of the monetary union and it may happen that in the aftermath of the crisis that started in 2007 the Governing Council decides in the future to proceed to a new assessment of the strategy. As it stands now I see no immediate need to make any changes or clarifications regarding our monetary strategy.

Q6. It is often asserted that due to structural changes in the world economy inflation has shifted from inflation in consumer prices to inflation in asset prices. What is your view on this assertion and which consequences for the monetary policy do you see?

Over the past two decades consumer price inflation has been successfully contained in the major industrialised economies. Low and stable inflation are not “natural” phenomena but are to a large extent testimony of central banks’ commitment to the objective of price stability, as is laid down in a large number of central bank statutes around the globe. Independent central banks have helped to anchor inflation expectations and thereby to dampen the propagation of relative price shocks to overall consumer prices and wages. Positive supply shocks linked with globalization and the inclusion of important low cost producers in world trade also helped to support the period of low inflation.

At the same time, however, we have been observing large swings in a variety of commodity and asset prices. On one side, globalisation in goods and services and increasing demand by emerging economies have had a discernible impact on the prices of oil, gas and other raw materials. On the other side, an increasingly globalised and underregulated financial system fuelled by ample global liquidity has led to large asset price misalignments, most noticeable during the recent financial crisis. The experience over the past two and a half years has led many observers to question the role of monetary policy in containing asset price inflation. Should a central bank react to asset prices directly or indirectly with regard to possible future threats to price stability? Can central banks detect which of the observed asset price booms are bubbles? These are important questions and to most of them a fully satisfying answer is still lacking.

The pre-crisis consensus view about monetary policy and asset prices questioned the ability of central banks to identify asset price misalignments in real time and assumed that ensuring low inflation in the market of goods and services would be enough to avoid significant asset price misalignments. Given this consensus, it was pointed out that a decisive easing of monetary conditions after the bursting of the bubble would be sufficient to sustain real economic activity and to minimise the probability of deflation. The present crisis challenged both assumptions and has forcefully demonstrated that the economic costs of large asset price misalignments and their subsequent correction can be devastating. In fact, the asset price bubbles that preceded the crisis happened in a period of general low inflation and although central banks may not anticipate the exact timing of the unwinding of financial imbalances, many policy makers did identify the building up of such imbalances as a source of concern in the run up to the crisis. This justifies that a central bank should actively monitor developments in asset prices and credit flows and the associated risks that they entail for price stability in the medium term.

In a trivial sense all central banks consider the indications of asset prices in thinking about monetary policy. For instance, the wealth effects stemming from asset appreciations will always have to be considered as they influence global demand, putting pressure on inflation. Beyond this role, there are several arguments against a tighter integration of asset prices in monetary policy objectives but those arguments also have good rebuttals. A point of general agreement is that no precise targets concerning asset prices could ever be defined as a concrete goal for monetary policy. On the other hand, though, monetary policy is not an exact science and economists and central bankers should not fall into the mistake of certain theoreticians stigmatized by Keynes as people who «prefer to be rigorously wrong rather than approximately right». After all, financial market disruptions can create episodes of unstable prices, in either direction, and central banks should not assume the asymmetric position that they only act to avoid the consequences of crashes in financial markets and do nothing when price booms or bubbles are developing. With the additional caution that using monetary policy to help contain incipient bubbles should not go to the point of creating unnecessary recessions, the attitude of «leaning against the wind» may have to be considered in certain moments, especially after the experience of the present crisis. Nevertheless, it should not be forgotten that the appropriate primary objective of monetary policy is to maintain price stability in consumer prices over the medium term. On the other hand, even if a possible help of monetary policy in certain episodes should not be ignored, the main contribution to financial stability needs to be ensured through instruments other than the policy interest rate and in the context of a broader framework of macro-prudential supervision.

Q7. How do you assess the consequences of rising oil prices for the monetary policy?

From a monetary policy perspective rising oil prices are important to the extent that they have a lasting effect on consumer prices. That said, monetary policy does not need to play an active role if oil price increases only temporarily affect consumer prices.

Specifically, the transmission of oil price shocks to consumer and producer prices and its eventual effects on inflation expectations require careful analysis to gauge an adequate response of monetary policy. Generally, these effects can be distinguished into first and second round effects. First round effects may have a direct impact on energy prices and thus consumer and producer prices. In addition, consumer and producer prices may also be affected indirectly as energy poses a significant input factor in manufacturing thus leading to increased cost pressures on non-energy components, which may eventually be passed on to consumer prices. As long as these first round effects remain limited, the economy can adjust to the relative price changes

with only a temporary impact on consumer price inflation. There is no need for monetary policy to take action.
On the other hand monetary policy needs to react if the first round effects start translating into second-round effects on consumer price inflation through wage growth developments and higher inflation expectations, the latter being an important variable in wage negotiations. If monetary policy fails to anchor inflation expectations over the medium to long term, higher inflation rates will be inevitable.
With its orientation towards the medium to longer term, the monetary policy of the Eurosystem decisively contributed to limiting the inflationary pressures caused by oil price increases during the period until 2008. Likewise, it should also continue to do so during future periods of oil price increases. Going forward great vigilance must be applied to safeguarding credibility through reactions against risks to price stability without entering into an overly activist approach. In this context, a clear and consistent communication of monetary policy decisions is particularly important for controlling the private sector's expectation formation.

Q8. Without prejudice to the objective of price stability, how in your view should the ECB fulfil its secondary obligations under the Treaty (to contribute to economic growth and full employment) and what instruments could the ECB use to do so?

The Treaty on the Functioning of the EU (Art. 127) stipulates that the primary objective of the ECB/Eurosystem shall be to maintain price stability. The notion of secondary obligations of the ECB refers to the second passage in Art. 127, which states that without prejudice to the objective of price stability, the ECB/Eurosystem shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. In this respect, Article 3 mentions as objectives of the Union, inter alia, balanced economic growth and full employment.
The meaning and operational consequences of this secondary objective have been much discussed. There is general agreement that in the long run there is no trade-off between inflation and growth or, to put it better, the best way for monetary policy to support the long-run growth rate is to maintain price stability, as this promotes efficiency in a decentralized market economy. A monetary policy which is credibly focused on price stability is the most effective contribution to permanent economic growth and high levels of employment. This statement is based on the insight gained from historical experience and academic research that monetary policy cannot give a permanent impulse to real values beyond the credible maintenance of price stability.
Price stability contributes to economic welfare and growth by eliminating inflation-related distortions. An environment of stable prices allows people to concentrate on productive activities rather than on strategies to protect their wealth and income against inflation. This is in particular to the benefit of the weakest groups of society, which have only limited possibilities to protect themselves against the effects of inflation. Another important benefit of price stability is that it reduces inflation risk premia in long-term interest rates. Thus, contrary to the view, heard occasionally, that a monetary policy geared to price stability will result in excessively high real interest rates, a price stability-oriented monetary policy will actually lead to lower real interest rates and thus increase the incentives to invest. Also, price stability avoids that progressive nominal tax brackets increase over time the real incidence of taxes and

social security contributions, which would induce a diminished incentive to supply labour and capital and thereby curtail the economy's long-run growth perspectives.

All the previous arguments indicate why there is no long term trade-off between price stability and growth, but the situation is different in the short term, a fact which is clear when there is a supply or cost-push shock to which monetary policy should not respond immediately in spite of the temporary increase in headline inflation. The credible achievement of price stability further fosters overall macroeconomic stability since inflation expectations are firmly anchored. As a result, adverse supply shocks, such as an increase in oil prices, have less effect on inflation and monetary policy can afford a more moderate and steady course of policy in face of such shocks.

More generally, even if one accepts the notion that the economy has a spontaneous tendency to go back to its long-term path, there is a short term trade-off because macroeconomic policy affects the speed of that convergence and may avoid higher output volatility, thus increasing the general welfare. Nonetheless, it is difficult to exploit this trade-off in a hierarchical mandate.

I take seriously the secondary objective defined by the Treaty, which the ECB has been clearly addressing in the present crisis. For instance, after the outbreak of the Lehman crisis, we acted quickly and forcefully to avoid the collapse of the banking system and to prevent its recessionary and deflationary consequences. Beyond dramatically lowering interest rates, the Eurosystem has also done its fair part in the enhanced credit support, namely in providing ample liquidity to the banking system, buying covered bonds thereby contributing to a revival of this important market and by accepting the European Investment Bank as counterparty to the monetary policy operations. I think there are few doubts that these actions have helped minimise the depth of the recession.

Q9. How do you assess the ECB's exit-strategy? Should monetary exit strategies be concerted globally? Should there be concertation between monetary and fiscal exit strategies?

The ECB's exit strategy comprises a gradual phasing-out of the non-standard measures introduced in response to the financial crisis. The gradual approach to the exit is necessary given the vulnerabilities of the real economy and of the financial system. The ECB announcement on the first steps of the phasing out of non-standard measures made in December 2009 precisely aims at this. I fully support this strategy. A gradual phasing-out allows all parties involved to adjust to the new conditions, while giving the ECB the possibility of receiving feedback on the phasing-out before deciding on the next steps. Let me underline that the phasing-out will certainly benefit from the design of the non-standard measures, which facilitates a smooth phasing out.

The Communiqué of the G20 Meeting of Finance Ministers and Central Bank Governors from 7 November 2009 (St Andrews) speaks a clear language as concerns the withdrawal from the extraordinary macroeconomic and financial support measures: "We agreed to cooperate and coordinate, taking into account any spillovers caused by our strategies, and consulting and sharing information where possible."

The spirit of this statement is in line with the ECB's strategy. As repeatedly stressed by the Governing Council, the cornerstone of the ECB's exit strategy is the clear link to the primary objective of price stability. All actions throughout the crisis have been taken resolutely with this primary objective in mind. When forming the real-time assessment of the risks to price stability, actions by other central banks are taken into account. Thus, while sharing information and other operational assistance may be desirable, no concertation of monetary policy appears warranted. In addition, while the crisis was synchronised at a global level, the recovery is likely to be more heterogeneous which by itself would call for different speeds in removing the degree of monetary accommodation.

There exists a broad consensus that all major central banks should tailor the exit from the extraordinary policy measures to the specific conditions that apply to the respective economy. At the same time, it is clear that international cooperation, such as in the form of the G20 consultations or regular Governors' meetings organised by the Bank for International Settlements, has been very useful in the past and will remain so in the future.

Regarding coordination with fiscal policy, it should be mentioned that there should not be ex ante coordination. Each policy maker should concentrate on its own area of responsibility and this should deliver the right policies. Of course, fiscal consolidation efforts by euro area governments are taken into account when forming the real-time assessment of the risks to price stability. On the other hand, when deciding on the fiscal policy stance Governments know that the Eurosystem reacts to any risk to the inflation rate exceeding the official objective for monetary policy. In modern economic models variables such as the output gap play a pivotal role to explain short term risks to price stability and this knowledge should act as a vehicle for spontaneous and autonomous implementation of the appropriate policy mix. But there cannot and will not be any pre-commitment to a particular course of monetary policy action. There is a regular exchange of information between the ECB and the governments of the euro area countries. Yet, coordination between the ECB and euro area governments should not go beyond what is foreseen in the Treaty.

Q10. What is your perspective on the asymmetrical exposure of Member States to an ECB exit strategy? What should be done in order to mitigate it?

Heterogeneity is an integral feature of the mechanics of adjustment in the euro area. Nevertheless, since the beginning of the euro, and contrary to some popular perceptions, GDP growth and inflation differentials across euro area countries have stood at historically low levels. Naturally, monetary policy per se cannot and should not aim at reducing these differentials. The premise of Economic and Monetary Union is a clear allocation of responsibilities among policy-makers; a commitment of both monetary and non-monetary policy-makers (including, in particular, fiscal authorities) to keep their own houses in order; and a set of safeguards to ensure that all parties abides by the rules. Euro area macroeconomic policies should be guided by these basic principles on which the EMU contract was signed.

In view of these principles, the overriding concern for the ECB's monetary exit considerations is and should be to maintain price stability in the euro area as a whole. This commitment of the Eurosystem provides the nominal anchor which acts as the single most important implicit coordination device for all other actors, including fiscal policy-makers, with their various responsibilities, in particular when forming their own exit and adjustment policies. This anchor must not be put at risk, especially not in a context of financial stability risk.

Furthermore, in a monetary union, countries must use the instruments at their disposal to facilitate their adjustment, in particular those relating to fiscal policy. The "fiscal exit" - or better, the "fiscal adjustment" - that will be necessary in the coming years is likely to prove more challenging for governments than the phasing out of non-standard measures for the Eurosystem. During the crisis, governments were right to

allow deficits to expand so that fiscal policy provided support to the economy in the short run. But now, government deficits are high – and indeed very high in many countries - government debt-to-GDP ratios are mostly high and rising; and the attention of financial markets is increasingly turning to issues of government solvency. Hence, prompt action to bring the fiscal house in order is necessary. The key issue for fiscal policy at this juncture is not “whether” but “how much” and “how soon” to start fiscal tightening. The proper conduct of policy will depend in each case on the speed of the recovery of the private sector economy. As long as fiscal policy is on an unsustainable course with government debt ratios still rising, the costs of further delaying adjustment will exceed the costs of acting sooner.
In addition to fiscal policy, other important policy of adjustment implies that financial supervisory authorities should monitor the situation in their financial system and deal, in a decentralised way, with occasional problems they may encounter. All in all, I am confident that a smooth exit will be achieved

Q11: “What measures should be taken by the ECB in order to avoid implicit subsidies and distortions related to the acceptance of a wider set of collateral through the enhanced credit support after October 2008?”

A broad collateral framework needs to be combined with appropriate measures to ensure, first and foremost, that the Eurosystem is protected from financial risks and also that incentives are preserved for banks to manage prudently their liquidity risk. The first measure, at the disposal of the central bank, is to ensure an accurate valuation of illiquid assets and the application of appropriate haircuts to account for the asset’s illiquidity. This requires a constant refinement of risk control measures, an avenue the Eurosystem has followed already before the outbreak of the financial market crisis, and with a heightened pace since then. The second measure relates to tender procedures applied in monetary policy operations. Competitive tender procedures, as applied by the Eurosystem before the outbreak of the crisis, ensure that the ability to refinance an asset with the central bank is appropriately priced. The third measure, which is currently prepared by the Basel Committee in the context of revising the regulation on liquidity risk, relates to imposing tighter supervisory and prudential policies concerning the management of liquidity risk. In combination, these measures should ensure that incentives for counterparties to manage and measure liquidity risk prudently are preserved.
As regards the avoidance of subsidies or distortions it should be stressed that the Eurosystem has in place an adequate risk control framework that minimizes this risk. The risk profile of the several assets is carefully monitored and less liquid and riskier assets are subjected to higher haircuts than safer, more liquid ones. In addition, the Eurosystem constantly monitors the value of the collateral and may make margin calls if it is deemed necessary in order to keep the collateral in line with the guidelines.

Q12: "How do you view the risk of unwinding regarding the huge volume of asset-backed securities (ABS) the ECB has accepted as collateral?"

The Eurosystem’s counterparties can use a wide set of marketable and non-marketable assets as collateral in ECB's operations. The marketable assets include a varied range of securities such as debt instruments issued by government, by central

banks, corporations, and credit institutions[1]. Asset backed securities (ABS) are thus only one type of instrument that can be used as collateral in ECB operations.
So far the amount of collateral available for ECB operations has been sufficient, even under the current crisis, to guarantee the counterparties' access to Eurosystem's liquidity. Indeed, during the last few years, the collateral put forward has corresponded to a relatively small share of total eligible assets and to more than double of the outstanding credit by the Eurosystem.
With regard to ABS in particular, I would like to recall that when the Governing Council decided on the enlargement of the eligible assets list, it maintained stricter rules on ABS, given the credit and liquidity risk of these assets. The minimum rating for eligibility of ABS was kept at A- and, following the result of the biennial review of the risk control measures in September 2008, ABS were classified under the lower liquidity category, which implies an haircut of 12% (an additional haircut is applied to ABS subject to theoretical valuation, i.e., the less liquid). On January 2009, the Governing Council has further refined its risk control measures for ABS with the objective of contributing to restoring a proper functioning of the ABS market. These refinements included a minimum AAA rating at issuance granted by two rating agencies (keeping the A for the remaining life of the ABS) and the prohibition of other ABS tranches in the underlying pool of the eligible ABS.
Against this background, eventual risks of the unwinding given the amount of ABS in the collateral are minimal both for the Eurosystem, given the risk management framework, and for the banking system, given the wide set of eligible assets available.

Q13. Against the background of rising public deficits and debt ratios, and 13 out of 16 Member States of the euro area being subject to an excessive deficit procedure, what is your assessment of the current implementation of the Stability and Growth Pact?

The economic and financial crisis warranted a loosening of fiscal policy in 2009. The adoption of co-ordinated fiscal stimulus measures, however, has stretched the fiscal framework embedded in the Treaty and the SGP. The SGP allows some flexibility in the setting of deadlines for correcting excessive deficits in the light of special or changed circumstances. Since the deep recession combined with a world-wide financial market crisis constitutes special circumstances, the Commission and ECOFIN Council have taken the view that the deadlines for the correction of the current excessive deficits should be set in a medium-term framework. Still, for most Member-states, the yearly structural adjustment necessary to fulfil the deadlines is very demanding, requiring sizeable additional measures. In this context, the current implementation of the Stability and Growth Pact seems adequate and should be rigorously implemented .
In some countries, deficits have increased to double-digit levels, coinciding with sovereign ratings downgrades and adverse financial market reactions. If governments do not promptly initiate the exit from the crisis-related budgetary loosening, government debt in the euro area is set to rise quickly to levels above 100% of GDP. These developments could severely damage the public's trust in the sustainability of public finances and, thereby, exert a destabilising effect on the euro area as a whole. Therefore, a strict and full implementation of the provisions of the Stability and

[1] For details see "General Documentation on Eurosystem monetary policy instruments and procedures", ECB, 2009.

Growth Pact (SGP) is of utmost importance to restore the sustainability of public finances and ensure a smooth functioning of EMU. The ECOFIN Council, in line with the provisions of the SGP, approved recommendations for the correction of excessive deficits in euro area countries and, in most cases, set a deadline by 2013. These recommendations must clearly be seen as a minimum effort necessary to restore sound and sustainable fiscal positions. It is now the responsibility of national policy-makers to live up to their commitments under the European Fiscal Framework and adopt credible and well-specified fiscal consolidation strategies.

Q14. In your view, are the procedures foreseen in the Stability and Growth Pact sufficient to ensure that Member States will return to budget discipline and long term sustainability of public finances? How can the rules of the Pact be used to prevent an excessive deficit procedure in the first place? What is your assessment of Member States' performance in good times as far as the reduction of their overall deficit is concerned?

The existing EU fiscal framework, as embedded in the relevant provisions of the Treaty and the Stability and Growth Pact, provides the legal and institutional preconditions for achieving and maintaining sound public finances. In particular, the deficit and debt ceilings, as well as the Medium-Term Budgetary Objectives establish common and consistent benchmarks for fiscal prudence across Member States. Thus, if fully respected and implemented in a stringent manner, they are a suitable tool to anchor and coordinate fiscal consolidation strategies and to guide public finances towards a sustainable path.
At the same time, in order for these provisions to be effective, Member States have to meet their responsibilities under the Pact. To that effect, a stronger national implementation of the EU fiscal framework is required. In particular, Member States should strengthen their domestic budgetary institutions to allow for a prudent and stability-oriented fiscal stance, notably in good times, which is needed to meet the common goals set out by the Stability and Growth Pact. These institutions should also be geared towards raising fiscal prudence outside crisis times which appears especially warranted in the light of recent experiences in Member States: while the downturn due to the financial and economic crisis severely affected public finances, the degree of budgetary deterioration in many countries also reflects a failure to consolidate their public finances in times of favourable economic conditions. In particular, those countries that had weak or vulnerable fiscal positions at the start of the downturn now generally face more pressing fiscal adjustment needs.

Q15. How do you evaluate the relationship and the cooperation between the ECB, the Council and/or the Eurogroup? Do you think that the coordination and economic surveillance inside the Eurogroup should be improved based on the Lisbon Treaty?

The ECB participates in meetings of the ECOFIN Council – which is the key forum for the coordination of Member States' economic policies – whenever matters relating to the objectives and tasks of the ECB are discussed. In addition, the ECB attends the meetings of the Eurogroup.
The relations between the ECB and the Council (ECOFIN) or the Eurogroup are not a one-way street. In fact, the Treaty (and the Statute of the ESCB and of the ECB)

explicitly provides for the possibility of the President of the Council to participate in meetings of the Governing Council and the General Council of the ECB. In practice, the Eurogroup President attends the meetings of the Governing Council (at the same time the Treaty expressly excludes any voting rights on the part of the President of the Council when participating in meetings of the ECB's Governing Council).

This interaction at the highest level enhances the flow of information between all parties involved, promotes mutual understanding of each other's policy views and allows for a dialogue on issues of common interest, in full respect of the respective responsibilities. In particular, the monthly meetings of the Eurogroup, on the eve of the ECOFIN Council meeting, provide a forum for the discussion among euro area policy-makers of issues connected with their shared specific responsibilities for the single currency and set the stage for an open dialogue in a climate of mutual trust and respect.

Looking back over the period since the creation of the ECB in 1998, this interaction has intensified over time. In particular, the financial turmoil in August 2007 marks the start of a more intense dialogue between the ECB and the ECOFIN Council.

The surveillance of the euro area requires further co-ordination. This applies in particular to two policy areas, namely competitiveness and budgetary developments. This has already been recognised by the Eurogroup, which decided to embark on a two-yearly surveillance of competitiveness developments within the euro area, including the adoption of country-specific recommendations. Since the introduction of the euro, a number of countries within the euro area have persistently lost competitiveness and run relatively large current account deficits. Another group of countries have suffered from structural weaknesses in their export performance. Finally, there is a group of countries which have accumulated large current account surpluses. As this trend of growing divergences is not sustainable, it calls for an intensified co-ordination of policies and for adequate policy responses at national level to tackle the underlying weaknesses.

The new Lisbon Treaty provides the euro area countries with new instruments, in particular the Articles 121 and 136 TFEU, to enforce such policy adjustments, in case individual countries fail to adopt them. The Eurogroup is the forum in which these processes should be activated. Furthermore, the new Treaty stipulates that the Council decisions taken in the context of the Stability and Growth Pact concerning euro area countries shall be taken by the euro area countries only, with the exclusion of the Member State concerned. The Eurogroup should fully exploit this legal possibility and thereby ensure the sustainability of public finances. I am looking forward to the Commission Communication on this matter.

Q16. What do you think are the most important objectives for the next Strategy for jobs and growth until 2020? Please list in order of importance the structural reforms which you believe are a priority in the EU and justify your choices. How could the ECB and the instruments of economic policy co-ordination (Broad Economic Policy Guidelines, Employment guidelines) contribute to the success of this strategy? What is your perception as to the possibilities of increasing internal demand and fostering investments within the EU?

The Europe 2020 strategy will be most effective if it keeps a clear focus on the primary objectives of keeping raising potential growth, creating high levels of employment and keeping sustainable public finances. This way, it would contribute best towards social inclusion and improving the living standards of European citizens.

There is a need for a strengthening of surveillance over Member States' policies in order to improve delivery on the commitments under the new EU 2020 strategy. In this respect it is key that the EU 2020 strategy should lay out a limited number of ambitious and country-specific targets (including in the internal market), firmly owned at the level of Member States. The new Europe 2020 strategy would best support structural and employment policies if it remains focused on the primary policy targets of raising potential growth and creating high levels of employment. Furthermore, the strategy should incorporate the greater interdependence among euro area members and their shared responsibility for the functioning of the euro area and hence the need for greater coherence and coordination of economic and fiscal policies among euro area members. In particular, it should target the competitiveness divergences that have arisen among euro area members since the introduction of the single currency, drawing on the recently established competitiveness review. In practical terms, I see merits in defining more specific policy guidelines, including more specific guidelines addressed exclusively to euro area members, as made possible under the new Art. 136 TFEU in the Lisbon Treaty. I therefore look forward to the Commission's Communication on these matters which is expected in spring 2010.

The ECB can contribute to the success of the EU2020 Strategy most effectively when focusing in its monetary policy on price stability in a credible manner and thereby supporting the purchasing power of euro area households. In this context it should be pointed out that a better functioning single European market makes it easier for monetary policy to achieve price stability and to support growth.

Consequently, structural reform measures should be aimed at enhancing competition to speed up restructuring and investment and to give way to new business opportunities, in particular in the services sector. This is crucial in order to engineer sustainable productivity growth supporting potential output and real income and in order to prevent the current crisis from affecting euro area potential growth in the long term. At the EU level, an important milestone for enhancing economic competition and efficiency is the completion of Single Market, the proper transposition of the common rules into national laws, and their rigorous enforcement.

Furthermore, there is a need for higher wage flexibility so that wage setting contributes to an adjustment of unit labour costs in the euro area by aligning wages to competitiveness positions, local labour market conditions and productivity developments, in particular in downturns. In order to avoid a further rise in unemployment, wages need to moderate beyond what has figured so far into negotiated wage developments for those countries marked by past competitiveness losses and for sectors being particularly hard hit by the crisis.

A revitalisation of internal demand in the current phase of low growth requires an improvement in households' and business confidence, in particular about future income streams. In this respect, short-term crisis support measures taken so far – specifically those supporting an adjustment in hours worked – have been successful in some cases in reducing employment losses. However, in the medium term, temporary policies delaying structural changes in the economies carry unnecessary budgetary costs and create inefficiencies, which undermine sustainable employment and real income growth. Therefore, clear and credible exit strategies are necessary to foster demand and employment in the medium term. In this respect, fiscal policies should improve the efficiency and quality of public spending and with a view to bolster investment and thereby potential output.

A final area where I think that the Lisbon strategy should press forward regards the energy sector. Besides issues related to climate change, over dependence on oil and other exhaustible resources constitutes a potential vulnerability and a possible source of macroeconomic instability. In this respect the role of the gyrations in oil prices and their impact on the euro area in the recent crisis should not be overlooked. Therefore, pushing forward strategies aiming at having alternative reliable sources of energy and an efficient energy sector should figure high in the next strategy on growth and employment.

Q17. What is your opinion regarding the pace of euro area enlargement both from the euro area's and the candidate countries point of view? How do you evaluate the introduction of the euro by New Member States up to now? Do you see a need for improvement or change in the accession process and/or the euro introduction period?

Following the introduction of the euro in 11 Member States in 1999, five additional Member States have adopted the euro in the meantime (including four countries that joined the EU in 2004). The benefits of the euro have thus increasingly spread also to new Member States, which shows that the euro area is not a "closed shop". There is no predefined timetable for the enlargement of the euro area. All Member States that have joined the EU since 2004 are expected to adopt the euro once they have achieved a high degree of sustainable convergence as prescribed by the Treaty and Protocol. This requires thorough preparation and should not be taken lightly.
The experience of Member States that have adopted the euro confirms that, when accepting new members into the euro area, we have to pay close attention to the sustainability of convergence. Achieving a high degree of sustainable convergence is essential, first and foremost for the country itself (so that it can reap the full benefits of euro adoption). In addition, it is also important for the euro area (as the achievement of the sustainable convergence of all participating countries is key for the coherence of the euro area and the efficient functioning of the single monetary policy). Setting out a credible strategy towards euro adoption (accompanied by the implementation of the necessary sound macroeconomic policies and structural reforms) could help to foster the commitment of all relevant parties towards this goal.
As regards the euro adoption process, the fundamental logic of the Treaty remains correct: countries have to make sure that they pursue sound macroeconomic policies. The institutional framework governing the process of euro adoption as enshrined in the Treaty and Protocol is designed to ensure that the preconditions for successful euro area participation are met. Strict adherence to this framework is, therefore, crucial. It is also extremely important that the convergence assessment is based on high quality and trustworthy statistical data.

Q18: What do you think about the currently lively debated issue of financial transaction taxes? Would such a tax rather merely raise revenues from the financial sector or is it more likely that it would limit socially undesirable transactions? What would be the role of the ECB in the implementation of an EU financial transaction tax? Based on currently existing financial transaction taxes (e.g. stamp duty in the UK), which could be the scope of such taxes in order to be effective? Which would be the risks and drawbacks of such taxes? Would such a tax be feasible if some countries do not adhere to its principles? Which

could be, to-put in the G-20 wording, other options "as to how the financial sector could make a fair and substantial contribution" toward paying for any burdens associated with government interventions to repair the banking system.

Let me start by stating my support to the idea that «the financial sector could make a fair and substantial contribution" toward paying for any burdens associated with government interventions to repair the banking system.» Nevertheless the notion that this objective would be better served by introducing a general financial transaction tax requires careful assessment. First, it needs to be clarified what the actual purpose of introducing such a tax would be to raise revenues from the financial sector and not so much to lower volatility in financial markets or to reduce incentives of excessive risk-taking.

Besides the difficulty in reaching the necessary international agreement to impose such a tax at worldwide level, and the fact that the tax would be paid ultimately by an increased costs to clients of financial services, even the revenue generation capacity of a financial transactions tax needs to be carefully evaluated. In particular, one cannot simply mechanically apply a tax rate of, for instance, 0.01 percent to the total amount of financial market transactions in order to estimate potential revenues, without taking into account its potential impact on (i) the overall volume of transactions, (ii) the prices at which transactions are executed, and (iii) other second-round effects. .

Hence, given the large uncertainty with respect to the effectiveness of a financial transactions tax, and its uncertain revenue generation potential, any financial transactions tax should be carefully assessed against possible alternatives. Such alternatives, however, in order to provide an efficient tool for promoting financial market stability in the future, would have to go beyond mere fund-raising schemes. In fact, the G20 and the IMF are working on a number of proposals which – apart from a financial transactions tax – also include taxation of bonuses and pay in the financial sector (targeting market participants' willingness to take excessive risk) as well as taxation of balance sheet items in order to prevent mismatches, all of which could be combined with insurance schemes to avoid the socialisation of future losses in the financial sector.

Contrary to the above mentioned tax - which is levied on financial transactions only - these options focus on individual institutions with the purpose of strengthening the resilience and the loss-absorbing capacity of the financial system as a whole. In this context, for instance, it is currently analysed the possibility to introduce additional prudential requirements on systemic financial institutions that due to their "too big to fail" status would most likely receive government assistance. These additional prudential requirements - in the form of capital surcharges and/or contingent capital - aim to increase the loss absorption capacity and the resilience to shocks of banks balance sheets and therefore to indirectly reduce the expected cost for tax-payers in future bail-outs.

Other measures under consideration aim to raise a monetary contribution from financial institutions thereby directly reducing or contributing to the (past or future) costs borne by public finances for government interventions. A prominent example is the introduction of a fee on financial institutions liabilities, as in the US financial responsibility fee. With its overarching objective of making the banking sector contribute to cover the costs of a financial crisis, the intention by the US administration to introduce a "responsibility fee" could be broadly shared.

In this framework, I would like to recall the position - recently expressed by the Eurosystem - that the crisis management and resolution framework should aim at reducing to the minimum the possible burden for taxpayers arising from any crisis of financial institutions. In this respect, I welcome the Commission's intention to further explore the feasibility of mechanisms that could ensure that private sector funds would be available at the time of a crisis. (see also Question 38)*-

Q19: What are your views on the future of the European monetary union in the longer term and what are the main challenges ahead?

It is crucial that as Europeans, we continue to build on the enormous success of establishing a single currency on our continent. The feat of European Union and of Monetary Union is unprecedented, and we should not forget how much we have achieved.

I believe that the future of European monetary union in the longer-term is a bright one. The recent coming into force of the Lisbon Treaty has given a new impetus to the process of European integration and this should improve the environment in which monetary union operates. Initial legitimate concerns and doubts about the euro have given way to appreciation of how the euro area works and its importance for the well being of the euro area economy and also, more and more, for the global economy.

That said, there are of course several challenges that are going to become more pressing ahead, not least because of the recent financial crisis .

A first point is related to the Stability and Growth Pact. After the deterioration of fiscal accounts brought about by the crisis and the necessary policy response to it, governments must again return to a more sustainable fiscal path. There is no doubt that this will require painful adjustments that will require a rather prolonged time of adjustment. In this process it is important that governments maintain a steady path and do not cede to the temptations for relaxing the prescriptions of the SGP as that would have serious implications for the workings of the monetary union.

Another major challenge has to do with the deepening and reinforcing of the European approach to financial stability and systemic risk. The setting up of the European Systemic Risk Board is an important step but much is to be done in the implementation and further co-operation in this field. In the long-term a European integrated approach towards financial stability and systemic risk is needed that will create the conditions for the development of a sound and robust financial system that will be less prone to crisis. In addition, it will be necessary also to take into account the risks stemming from global sources, in collaboration with the IMF and the Financial Stability Board.

So we need to consolidate the successes so far and continue on the path of the first decade of existence of the euro. This means for all actors, all institutions at European and national level, but also all economic agents, to live up to their commitments and responsibilities. In this way, we will better be able to meet the longer term challenges that are likely to arise in a world surrounded by uncertainty; so that we may continue to prosper as a society.

I can assure you that, I will continue to do everything in my powers to ensure that our currency and the ECB continue to thrive on the basis of the credibility established so far.

Q20. What is your view of the respective roles of the Council, the Commission, the Euro group and the ECB in terms of external representation of the Euro zone?

The external representation of the euro area reflects the special nature of EMU as a union with a centralised monetary policy but decentralised economic policies. Representation is divided between the Council, the Commission, the Eurogroup, the ECB, and the Member States in accordance with the allocation of powers provided for in the Treaty.

The ECB represents monetary policy and its other responsibilities externally. The ECB acts as the voice of the Eurosystem and is represented in the most important international fora which are relevant to the Eurosystem's tasks. This arrangement works well.

The external representation of euro area economic policies is more fragmented due to the division of internal responsibilities between the Union and the Member States. Member States remain largely responsible for economic policies. They are also members of international economic fora such as the IMF, where they may bear financial responsibilities.

At the same time, the current economic and financial crisis has underscored the need for enhanced European representation to ensure that Europe can represent its interests effectively on the world stage. Article 138 of the Treaty – which provides that the Council (in euro area composition) can adopt "common positions on matters of particular interest for EMU" and "ensure unified representation within the international financial institutions and conferences" – could be used in this regard. Progress depends, however, on the political willingness of Member States.

Q21.

A. ***How do you assess the recent evolution of the USD/EUR exchange rate?***
Developments in foreign exchange markets over the past 18 months have been shaped, to a large extent, by the evolution of the financial crisis. At the height of the crisis, portfolio shifts into the US government bonds provided strong support to the US dollar vis-à-vis the euro (and other currencies) amid very high financial market volatility. When financial tensions gradually subsided in the course of 2009, these flows were partly unwound and the euro rebounded considerably. As a result, in autumn 2009, the euro traded at rather high levels by historical standards, before it started depreciating over the past two months. The ECB, through its President, has been on record numerous times over the past 18 months indicating that we welcome the statements by the US authorities that a strong dollar is in the interest of the United States.

B. How do you assess the recent evolution of the Renminbi/EUR exchange rate?

The renminbi has appreciated vis-à-vis the euro only moderately since the start of China's exchange rate reform almost five years ago, namely by about 7.4% from July

2005 until 22 February 2010 (against 21% vis-à-vis the US dollar and 14% in real effective terms on a consumer price index basis). This is notably due to the interruption of China's policy of gradual exchange rate appreciation when the crisis broke out.

I therefore welcomes China's continued commitment to move to a more flexible exchange rate, which should lead to continued appreciation of the Renminbi in effective terms and help promote more balanced growth in China and in the world economy.

C. How do you evaluate international co-operation in the field of exchange rates?

The ECB has constant exchanges of views on global exchange rate configurations with its partners in the Group of Seven (G7), whose leading role on exchange rate issues was reasserted at the Group's last meeting in Iqaluit, Canada, on 6 February 2010. Together with its G7 and G20 partners, the ECB monitors exchange markets closely and cooperates as appropriate.

The degree of mutual understanding on both sides of the Atlantic is particularly high and I appreciate that the US authorities, including Chairman Bernanke and Treasury Secretary Geithner, indicated that a strong dollar is in the interest of the U.S. economy, which is also in the interest of the global economy itself.

The ECB also has regular exchange of views with Chinese authorities in an open and candid fashion.[2]

D. Do you think that central banks are able to fight efficiently against excessive volatility?

G7 central bank Governors – together with G7 Finance Ministers – reaffirmed their shared interest in a strong and stable international financial system at their last meeting in February 2010.

They also made clear that excess volatility and disorderly movements in exchange rates have adverse implications for economic and financial stability and that they would continue to monitor exchange markets closely and cooperate as appropriate.

Regarding central banks' ability to address excessive exchange rate volatility, it should be made clear that the euro area has adopted a flexible exchange rate regime, implying that the external value of the euro vis-à-vis the currencies of third countries is determined by the market. This allows the ECB to focus on its objective – the preservation of price stability – and should contribute to limit exchange rate volatility. However, episodes of overshooting and undershooting may nevertheless develop in exchange rate markets, which may have an impact on price trends and imply risks to price stability in the euro area. In these cases, public intervention to limit excessive exchange rate volatility may be warranted provided it is coordinated with other countries. A general feature of exchange rate policy is that it is by definition international. An exchange rate cannot be determined by one country or economic area; it always depends on the decisions of at least the two parties involved. Therefore, international cooperation is crucial for the effectiveness of the exchange rate policy

[2] In particular, the ECB President, together with the Eurogroup President and the EU Commissioner for economic and monetary affairs paid visits to their Chinese counterparts in November 2007 and November 2009 to discuss issues of common interest.

E. What importance do you give in this context to the dangers posed by global imbalances?

The accumulation of large current account imbalances globally was a contributory factor in the escalation of systemic risks that ultimately led to the financial crisis. The crisis is leading to a narrowing of these imbalances which is, however, mostly cyclical rather than structural. This suggests that global imbalances risk widening anew as the global recovery gathers strength.

The multilateral nature of global imbalances implies that resolving them should be a shared responsibility. The new G20 Framework for strong, sustainable and balanced growth provides an opportunity to enhance surveillance of macroeconomic policies among major economies to achieve more balanced global growth and avoid the re-emergence of large global imbalances. It is now important to agree on concrete policy measures and ensure that commitments are followed up, with all the major economies doing their part.

F. Do you think that the international role of the euro should be encouraged and if yes, how?

I agree with the policy of the ECB, followed since the beginning of monetary union in 1999, of not campaigning to foster nor hinder the international use of the euro. Developments in the role of the euro abroad are primarily the result of market forces and private sector decisions. The main support which the ECB indirectly provides to foster a greater use of the euro in international transactions is by pursuing a credible monetary policy. The ECB monitors the international role of the euro and provides regular information to the public, in particular in its annual *Review of the international role of the euro*.

Q22: How can the importance of the euro area and its currency be further enhanced, in particular in international financial institutions? What are your views on the current level of coordination, e.g. before IMF board meetings?

Since the inception of the euro more than a decade ago, the euro area has gradually become an established partner in global fora and institutions dealing with economic and financial issues, like the BIS, G7, G20, IMF or the FSB. This is the result of a gradual process during which long-standing patterns had to be changed, both in institutions and in the mindset of people. While not trivial, it seems easier to change the former than the latter.

The rules for participation in global institutions and fora had to be adjusted to allow for the interaction with a currency area and its actors instead of the representatives of single countries. This was accommodated for example in the G7 by inviting the ECB President and the Eurogroup President to the meetings and at the IMF by granting the ECB an observer status, which allows participation in a number of IMF Executive Board meetings. Likewise, new structures have been established, for instance European representatives meet regularly in Washington to exchange views on topics before they are actually addressed in the IMF Executive Board meetings.

By contrast, it is more difficult to change the mindset of the actors. Given the advent of monetary union, monetary policy and exchange rate matters have now to be represented at the Union level. This is relatively clear-cut. But it is less clear-cut that also in other policy areas there is a case for coordinating views and agreeing on common messages. Progress has been achieved, since many common terms of reference on various topics of the agendas of the G7, G20 and IMF have over the years been coordinated in Brussels. However, it is not yet fully internalised that speaking with one voice will ultimately help to achieve common goals. Countries often perceive international policy matters still as a national prerogative, despite the fact that the euro area is exposed to the same global challenges. This attitude often prevents terms of reference from being more than the smallest common denominator and leads to sometimes diverging messages. Unfortunately, a choir of different voices does not pave the way for enhanced influence. This might explain today's situation that, on the one hand, the influence of the euro area in international financial institutions is not yet commensurate to its economic and financial weight compared to other major parties, while, on the other hand, the euro area (or the EU more generally) is often perceived and accused for being over-represented.

Looking forward, Europe will have to reconsider this situation not least because of external pressure arising in the context of the the IMF (v.g. by considering a single chair approach). In my view, calls for even better coordination of views and for reconsidering whether there are more efficient ways of being represented in international institutions and fora are clearly warranted in order to strengthen the weight of the euro area on the global stage.

C. Financial stability and supervision

Q23. What do you think of the financial supervisory draft legislative proposals currently debated in the European Parliament?

The draft legislative proposals currently debated by the European Parliament are part of a comprehensive review of the EU institutional framework for supervision, which includes both the enhancement of micro-prudential supervision through the establishment of the European System of Financial Supervision (ESFS) (comprising three European Supervisory Authorities and the network of national supervisors), and the designation of the European Systemic Risk Board as a new independent body, responsible for safeguarding financial stability by conducting macro-prudential supervision at the European level, with the conferral of specific related tasks on the ECB on the basis of Article 127(6) of the Treaty.

The proposed institutional framework is broadly appropriate for the following reasons:

On the micro-prudential side, the establishment of the ESFS will support increased consistency in the conduct of micro-prudential supervision at the EU level. In this context, the main tasks proposed for the European Supervisory Authorities are broadly appropriate to achieve these objectives. In particular, the elaboration of technical standards, guidelines and recommendations will allow fostering consistent application of EU financial legislation across Member States and a common regulatory and supervisory approach at the EU level. There is a wide-spread consensus about the objective of creating a single EU rulebook which would be the basis for cross-border services by financial intermediaries. This will ensure a level playing field among financial institutions and an adequate protection of depositors, investors and consumers in Europe.

On the macro-prudential side, the establishment of a new body responsible for the conduct of macro-prudential oversight in the EU – the ESRB – should be welcome since the recent financial crisis has demonstrated the need to strengthen the macro-prudential approach to regulation and supervision of the financial system as a whole. The crisis has also demonstrated the need to assess the various sources of systemic risk and their consequences for the financial system in a comprehensive and timely manner. The ESRB, by identifying and assessing systemic risks, by issuing early warnings and recommendations where such risks are significant and by monitoring the follow-up, can significantly contribute to the stability of the EU financial system as a whole. In this context, it is also appropriate that the draft legislative proposals envisage that the ECB and the European System of Central Banks (ESCB) play a key role in the functioning of the ESRB. In particular, the participation of all the members of the General Council of the ECB in the ESRB will ensure that the financial stability analysis of the ESRB will benefit from the macro-economic, financial and monetary expertise of the EU central banks. In addition, the ECB will provide analytical, statistical, administrative and logistical support to the ESRB.

The legislative proposals have therefore the potential to provide a significant enhancement of the EU's supervisory architecture which is able to answer the global and European regulatory demands following the financial crisis. Furthermore, and most importantly, the new structures will provide a regulatory framework which should safeguard the significant and valuable progress made so far in financial integration in the EU, as well as foster further integration.

Nevertheless, I see the need for further progress of certain aspects. In a sense, the solution that is being devised lays half-way between a purely national approach to micro-prudential supervision and a full-fledged pan-european supervisory function. Going forward, the main issue seems to be whether the ESA prove sufficient to ensure a unified and effective response to the activity of cross-border financial groups or if there will be a need to take another step forward. In this process, the implementation of a true single rule book will create one of the conditions for an effective functioning and empowerment of the ESA. However, the most important element to bear in mind is that the responsibility and powers for financial supervision need to be in the hands of those who ultimately have to pay the possible costs of failure in the financial system. In my view, any potential move towards an even more integrated supervisory architecture in Europe will therefore have to be preceded by the establishment of a European safety net (including an ex-ante funded Resolution Fund)

What would you recommend to strengthen the links between macro and micro supervision?

A key condition for the efficient and effective functioning of the new European supervisory architecture is to ensure an appropriate interplay between the EU macro-prudential oversight function – represented by the ESRB – and the micro-prudential function – represented by the ESFS. The aim of the proposed architecture is that the focus of the work of the ESRB will be macro, systemic and economic in outlook, while the work of the ESFS will be micro, prudential, and regulatory. In this context, it is important to achieve the right synergies between the micro- and macro-prudential functions in safeguarding financial stability, also in order to avoid overlaps and duplication. This requires a well-defined distribution of tasks, as well as working procedures which allow mutual support and exploiting synergies between the two functions.

The draft legislative proposals already contain a number of provisions, which should underpin the close cooperation between the ESRB and the ESAs. In particular:

- First, in terms of governance, the three chairs of the ESAs should be voting members of the General Board of the ESRB, and also members of its Steering

Committee. Conversely, the ESRB should be a member (non-voting) of the Board of Supervisors of each of the three ESAs. Moreover, the three ESAs should be also represented in the Advisory Technical Committee, which will be a main provider of technical input to the ESRB.

- Second, the ESAs should be subject to a general duty of close cooperation with the ESRB. In this context, it is already foreseen that the ESAs will be one of the main providers of information to the ESRB. In particular, the ESRB may request information from the ESAs in summary or collective form, such that individual financial institutions cannot be identified. The ESRB may also address a reasoned request to the ESAs to provide data that are not in summary or collective form when the latter are not sufficient.
- Third, the ESAs should support the implementation of recommendations addressed to one or more competent national supervisory authorities. In particular, the ESAs should be required to use their powers to ensure a timely follow-up. Furthermore, when a national supervisor does not follow up, it should inform the Board of Supervisors of the respective ESA. In its reply to the ESRB, the national supervisor should take into account the input of the respective ESA.
- Fourth, the ESAs will be responsible for monitoring and assessing market developments, particularly with regard to the relevant micro-prudential trends, potential risks and vulnerabilities. For this purpose, the ESAs should conduct stress-testing exercises in cooperation with the ESRB. The outcome of such monitoring and assessment should be conveyed to the ESRB.
- Fifth, the ESRB and the ESAs should also be expected to cooperate in the case of a crisis situation. The ESAs are obliged to notify the ESRB of any potential emergency situation without delay. The ESRB may also play a role in the declaration of an emergency situation.

The combination of these mechanisms should provide an appropriate framework for the close cooperation between the ESRB and the ESAs. The following challenges could be highlighted:

- First, a crucial aspect for the effectiveness of the ESRB will be the access to a comprehensive information base, including information of a micro-prudential nature, which can provide backing to the ESRB risk warnings and policy recommendations. This will require a close interplay with the ESAs, particularly in a manner that ensures strict confidentiality in the use of micro data and also avoiding as much as possible any additional reporting burden on financial institutions. Accordingly, the ESRB and the ESAs will need to agree on the appropriate arrangements in this respect.
- Second, the ESRB will need to rely on the close cooperation with the relevant supervisory authorities (banking, insurance and securities supervisors) for the monitoring of risk exposures within and across financial sectors. This will require setting-up appropriate links through which the “output” of the analyses and assessments of the ESAs and national supervisors is channelled to the ESRB. Conversely, there should be also mechanisms to ensure that the risk analyses and assessments of the ESRB are communicated to the micro-prudential supervisors and help trigger the appropriate policy measures.
- Third, the ESAs should play a very important role as regards the implementation of the ESRB’s recommendations when the latter are addressed to supervisory authorities. In particular, the ESAs should be attributed the possibility of using

their tools to support as much as possible the implementation of the ESRB recommendations.

Do the Commission proposals give proper role and responsibility to the ESRB?

The Commission proposals give a broad mandate to the ESRB in the macro-prudential oversight of the financial system of the EU as a whole. In particular, the ESRB has to take account of risks arising from developments within the financial system and taking into account macro-economic developments. This broad role is appropriate as one of the key lessons of the financial crisis was the need to consider widely the potential for systemic risk arising from developments in the interconnectedness among financial institutions and markets, which may increase the scope for contagion, as well as from the close links between the financial system and the real economy. Accordingly, the broad mandate of the ESRB does not pose any limitations to a full and thorough assessment by the ESRB of emerging systemic risks. Regarding the responsibilities of the ESRB, they concern mainly the identification and prioritisation of systemic risks, the issuance of risk warnings when systemic risks have been identified, and the issuance of recommendations for remedial actions in response to the risks identified.

In this context, the ESRB benefits from a broad membership and from the possibility to seek input from diverse sources – supervisors and from all public and private stakeholders – which will be important in view of identifying and prioritising risks and also issuing specific risk warnings and, where relevant, recommendations.

One of the main challenges for the effectiveness of the ESRB will be the issuance and implementation of its risk warnings and recommendations. The ESRB will need to rely on the following:

- First, the quality of the warning recommendations will be crucial. This implies that the ESRB will need to develop the appropriate information base, analytical models, and expertise to ensure the maximum quality. This, in turn, will provide the basis for its policy credibility. In this context, an important element will be the knowledge and expertise of supervisory authorities, which will be required in the design of specific recommendations on regulatory and supervisory actions.
- Second, regarding the procedure for the issuance and follow-up of risk warnings and recommendations, it is appropriate, as foreseen in the Commission proposal, that the ESRB risk warnings and recommendations are directly transmitted to the respective addressees, with parallel transmission to the ECOFIN Council. At the same time, the addressees of the recommendations should report directly to the ESRB on the basis of the "act or explain" principle. This enhances the independence and credibility of the ESRB.
- Third, the ESRB can resort to the publication of its risk warnings and recommendations. This instrument can also foster the appropriate follow-up. In addition, it is expected that the EU Council and the ESAs may play a role in supporting the implementation of the ESRB recommendations.

Overall, the Commission proposals provide for an appropriate role and responsibilities to the ESRB. It is important to note that macro-prudential oversight should not be regarded as a substitute for the responsibilities of other authorities, namely supervisors. It should instead facilitate and complement where required the conduct of micro-prudential supervision by the competent authorities.

Is the institutional balance between Union institutions appropriate?

The EU institutions are involved in the ESRB at different levels. The Commission is a voting member of the General Board, which is appropriate given its role in legislative initiatives as well as in the macro-economic and financial surveillance of the Union. The EU Council is represented in the General Board through the presence of the President of the Economic and Financial Committee (EFC) as a non-voting member. This reflects the role of the EFC in providing advice to the Council in matters relating to economic and financial policies, including financial stability. The Council is also involved in the procedure envisaged for risk warnings and recommendations, as it will receive risk warnings and recommendations at the same time as the addressees, and it will also receive the communications from the addressees. The European Parliament is mainly involved in the reporting obligations of the ESRB (together with the Council) and also in reviewing the effectiveness of the legislation after three years of experience. This is also appropriate given the role of the Parliament in legislation and in holding the ESRB accountable. The ECB is entrusted with the provision of the analytical, statistical, analytical and logistical support, so as to exploit the specific competencies of the central banks.

The institutional balance is broadly appropriate, as all EU institutions will be involved in the functioning of the ESRB in the context of their respective functions.

What do you think about the overall composition of the ESRB and its Steering Committee?

In line with the proposals made by the De Larosière Report, it is appropriate that the ECB's General Council provides the basis for the voting members of the General Board. The EU central banks are well suited to be the authorities mainly responsible for macro-prudential supervision, given the close links that central banks have with the monetary and financial markets in order to perform their monetary policy tasks. In addition, the ECB's General Council is a well-established decision-making body, which has carried out a wide range of central banking tasks since 1999. Therefore, the good experience with the General Council provides a good basis for a smooth functioning of the ESRB. Referring to the General Council also implies that the President of the ECB should be the *ex officio* chair of the ESRB and that the ECB Vice-President is a member of the General Board.

It is also important to include in the General Board the three Chairs of the European Supervisory Authorities, as well as the heads of national supervisory authorities as non-voting members, given the importance of the close interplay between the ESRB, the ESAs, and national supervisors as explained above. The participation of the Commission and the EFC are also relevant, given their role in legislative initiatives, macro-economic surveillance and economic and financial policies.

The composition of the ESRB's Steering Committee should reflect that of the ESRB's General Board in order to ensure that the Committee is representative of the Board, whose meetings it is meant to prepare. Therefore, the inclusion of five central bank members (in addition to the chair and vice-chair of the ESRB) ensures an appropriate balance among central bankers and the other members of the Steering Committee. In addition, it allows for sufficient representation of the euro area and non-euro area national central banks. However, as the composition of the euro area will change with time, it would not be advisable to lay down in a legal act a specific, immutable allocation of seats between euro area and non-euro area central banks.

Could you elaborate on your views as to the powers of the ESRB: how to make sure that warnings and recommendations cannot be ignored by the addressees?

As mentioned already, the effectiveness of the ESRB warnings and recommendations will rely on their quality, the "act-or–explain" mechanism between the ESRB and the addressees, the possibility of the ESRB to publish its warnings and recommendations, and also the possible role of the EU Council and the ESAs in supporting the implementation of the warnings and recommendations.

A close monitoring and assessment by the ESRB of the follow-up action that has been given to its recommendations will be decisive. When the ESRB considers that the actions taken or reasons for inaction are insufficient, multilateral pressure and public disclosure are two important instruments to be considered. Taking into account the sensitive nature of the underlying information and the disruption it may cause in institutions and/or markets the decision to make the warnings and recommendations public should be made by the ESRB on a case-by-case basis. The combination of these elements should provide an adequate framework of incentives and mechanisms, which will increase the likelihood of compliance with risk warnings and recommendations.

Is the level of public disclosure appropriate in your opinion?

The ESRB output, in the form of risk assessments, warnings and recommendations, will have a sensitive nature. In particular, the disclosure of the ESRB assessments may have a direct impact on the perception of market participants as to financial stability conditions. Accordingly, the ESRB's communication policy will need to be carefully considered.

At the same time, it will be important for the ESRB to keep the public informed of its regular activities and contributions to safeguarding financial stability. This can be achieved through the reporting obligations of the ESRB to the European Parliament and the Council, and also through regular publications on financial stability in order to raise the awareness of market participants and the public to certain risks and vulnerabilities.

Do you see a potential conflict of interest with the ECB mandate in relation to monetary policy?

The primary objective of the ECB is to maintain price stability. This mandate given to the ECB/ESCB remains unchanged. The Treaty not only unambiguously establishes price stability as the primary objective of monetary policy but defines also a clear hierarchical mandate when it mentions the secondary objective.

The assignment to the ECB of specific tasks concerning the functioning of the ESRB is welcome, as it enhances the ECB's contribution to financial stability. This new task should not be seen as constituting an additional objective of monetary policy. Instead, this new task should contribute to financial stability, without compromising on the primary objective of price stability.

Consequently, the creation of the ESRB does not change the clear allocation of responsibilities enshrined in the Treaty. It will also maintain the integrity of the overall macroeconomic analysis conducted within the ESCB as well as the internal organisational structure of the ECB.

It is important to ensure that the ESRB and all its members are provided with a high degree of independence from political influence. In this regard, the supporting activities by the ECB to the ESRB should neither affect the ECB's institutional, functional and financial independence nor the ESCB's performance of its tasks under the Treaty and the Statute of the ESCB and the ECB, in particular its own independent financial stability and oversight tasks for the euro area economy.

Q24. How do you see the evolution of the European supervisory architecture in the medium and long term? In particular, what do you think of a single European supervisory authority?

The establishment of the three ESAs is a major step forward. It allows building on the experience and the work conducted by the Level 3 "Lamfalussy" Committees, which played an important role to foster supervisory convergence in Europe and to forge mutual trust among the national supervisors. The establishment of the ESAs seeks to remedy one of the major weaknesses of these Committees, namely the non-binding nature of their guidelines. The possibility to issue legally binding technical standards will allow creating an EU financial services rulebook, which will promote a level playing field and contribute to the adequate protection of depositors, investors and consumers in Europe.

In the medium to long term, I do not agree with the idea of a single European supervisory authority and, in general, the performance of that type of solution at the national level during the financial crisis should warn us its adoption at the European level. I do see the merits in having a single authority for the prudential supervision of all financial institutions, including banking, insurance and pension funds. Supervision and regulation need to keep up with the developments in financial markets and indeed we have been witnessing a progressive integration between the different sub-sectors of the financial system, of which the emergence of financial conglomerates is but the most noticeable implication. In the current environment it is therefore important for supervision to adopt an integrated approach that allows for a deep understanding of the (not so) new business models instead of a separated approach for banking and insurance, which may fail to capture the interconnectedness among sub-sectors and the associated risks.

On the other hand, I make a clear cut distinction between supervision of financial institutions and the supervision of the securities markets. It is important to acknowledge that the objectives of these two functions are inherently distinct, and actually conflicting in certain instances, and even the modus operandi and data resources of the two areas of financial supervision share little similarities. The possible conflict of interest stems from the fact that the supervision of institutions must have as its predominant public goal to defend the interests of depositors and clients whereas the perspective of securities market supervision is to cater first for the interest of investors and shareholders. Two different attitudes stem from these two principles regarding the concern with institutional stability.

In my view, there are also strong arguments for the supervision of the conduct of business of financial institutions in the relationship with their costumers to be undertaken in close proximity with prudential supervision. The most notable of those arguments relates to the fact that the regulation and supervision of retail banking and insurance products and services and of the way they are marketed and sold to clients is bound to have an implication in the profitability and solvency of financial institutions, thereby impinging on prudential supervision. Moreover, there are important negative externalities resulting from an inappropriate handling of information collected in the context of business conduct supervision and there have even been recent cases of significant prudential problems being triggered by inappropriate business conduct in the relationship of banks with their retail clients. All things considered, I tend to be inclined towards a twin-peaks model of micro-prudential supervision grounded on two main institutional pillars: on the one hand, the prudential supervision of all financial institutions as well as the protection of the retail traditional banking and insurance costumer, including both the safeguard of their funds and the protection of their interests in the commercial relation with financial institutions; on the other hand, the safeguard of the integrity and efficiency of the securities markets, including the protection of the investor in those markets.

How do you see the ECB's role in banking supervision in the future?

In general, the experience of the financial crisis has strengthened the arguments in favour of the involvement of central banks in prudential supervision. In an increasingly market-based and interconnected financial system, disturbances are likely to affect core market mechanisms, such as the distribution of liquidity, have cross-border implications and propagate in a more unpredictable manner. An adequate appreciation of such dynamics requires a cross-border systemic perspective as well as appropriate resources and expertise for financial stability analysis as it is the case with central banks. Moreover, during the financial crisis the synergies between the central banking and the supervisor functions have been evident with particular regard to the gathering and assessment of the information. Taking stock of such experience, in a number of Member States it is planned to strengthen the role of central banks in prudential supervision. Such developments may over time suggest further considering the institutional role of the ECB and the possibility given by the Treaty to confer specific tasks in the field of prudential supervision upon the ECB, also in the light of further enlargement of the euro-area and the requirements of more intense supervision of the so –called «too big to fail» institutions.

The Eurosystem institutional framework relies on a decentralised operational approach which allows exploiting fully the national authorities' expertise and existing infrastructures. This setting has proved effective in managing the institutional tasks assigned by the Treaty also in the context of the financial crisis. It could provide an appropriate framework for the exercise of supervisory responsibilities. It is worth pointing out that the arguments normally used to argue for caution regarding the involvement of central banks in financial supervision do not hold at national level within the context of European monetary union.

Q25. To what extent and how quickly should financial institutions increase their equity capital?

To cushion the risks that lie ahead, banks will need to be especially mindful in ensuring that they have adequate capital buffers in place. In this perspective I agree with the main thrust of the envisaged regulation by the Financial and Stability Board and the Basel Committee on Banking Supervision and its introduction in 2012, provided with indispensable transition periods and grandfathering principles. In addition, some banks, especially those which have received state support, may need fundamental restructuring in order to confirm their long-term viability when such support is no longer available. This could involve the shrinking of balance sheets through the shedding of unviable businesses with a view to enhancing their profit-generating capacities. At the same time, banks should take full advantage of the recent recovery in their profitability to strengthen their capital positions, so that the necessary restructuring of businesses and the enhancement of shock-absorbing capacities do not impinge materially on the provision of credit to the economy.

Q26. How can the competitive disturbances that have developed following the crisis and rescue measures taken by the government and central banks of the Member States be eliminated?

Although government measures in support of the financial system have been effective in averting an escalation of the financial crisis, a concern exists that support measures could themselves create considerable distortions of competition (i) within countries, as government support and rescue schemes provide an advantage to benefiting banks relative to banks without access to support schemes and (ii) across countries when public support by one country is more favourable than in other countries. Although the efforts for harmonisation of support measures in the EU have contained the distortionary effects, some evidence pointing to distortions of competition has appeared.

The European Commission, which is responsible for monitoring the situation in the market and reviewing Member States' public support measures, has thus far not reported any instances of significant distortion. At the same time, one indication of potential distortions emerges from spreads of government guaranteed bonds. These spreads diverge for banks with the same rating but which are head-quartered in different countries. This suggests that sovereign risk has been a key driver of these spreads but it also points to a distortion whereby 'weak banks from strong countries obtain cheaper funding'. Enhanced deposit insurance is also likely to have distortionary effects on cross-border competition. However, both government guaranteed bond programmes and enhanced deposit insurance are likely to be phased out over the coming months, thereby eliminating the main sources of competitive disturbances, while it cannot be ruled out that temporary impacts on factors of competition could have a long-lasting impact on market competition.

Another tentative indication that the degree of competition in the banking sector across euro area countries may have changed can be gauged from the fact that cross-country dispersion of retail bank loan and deposit rates markedly increased in the second half of 2008 and have remained high (from a historical perspective) throughout 2009. Apart from reflecting idiosyncratic factors affecting individual banks, it cannot be excluded that this development to some extent also reflects effects on cross-border competition triggered by differences in government support measures, which, via their effects on individual banks' cost of funding, are being transmitted to the interest rates offered to banks' retail customers. That being said, empirical evidence suggests that even during the financial crisis the pass-through of policy rates to retail bank interest rates in the euro area has functioned broadly in line with historical experiences. In addition, information from the Eurosystem's Bank Lending Survey also does not suggest that competition (or lack thereof) has been a major factor in the observed net tightening of euro area banks' credit standards since Q3 2007.

Central bank support measures within the Eurosystem aim at the banking sector as a whole and as such entail fewer risks of entailing discriminatory treatment. Although they are not necessarily free from risks of introducing certain market distortions, the risk of these measures introducing distortions in the field of bank competition is limited, at least in the short run. This applies to both the standard refinancing operations offered by the Eurosystem to euro area Monetary Financial Institutions (MFIs) and to the non-standard measures introduced during the financial crisis. Taking instead an international perspective, the non-standard monetary policy measures introduced by the Eurosystem since October 2008 differ somewhat from measures introduced by central banks in other jurisdictions and hence the level-playing field across global banks (and also between euro area and non-euro area banks) might have been affected. However, it has to be borne in mind that the measures undertaken by central banks around the world in the context of the crisis were tailored to the specificities of the financial and economic structures prevailing in their economies. Moreover, operational frameworks across global central banks differed also prior to the financial crisis. Finally, any distortions to the international level-playing field implied by the central bank crisis-measures should evaporate once these measures are terminated and thus should not be expected to have any long-lasting impact on bank competition.

While competitive distortions appear in principle to have been largely contained, the distortions of incentives present another important concern arising from the support measures. More specifically, the rescue measures have been primarily in support of large and systemically important banks whose failure may have threatened the stability of the financial system. Consequently, these banks may be benefiting from market perceptions of an implicit bail-out guarantee from the government, allowing them to pursue profitable but risky business without the appropriate market discipline. Several proposal have been put forward to deal with this so-called 'too-big to fail' issue

Q27. How can financial institutions be forced/incentivised to reduce their risk appetite?

The ongoing regulatory reform on strengthening the resilience of the financial system will contain several elements that will provide incentives for prudent risk management for banks. In this context the Basel Committee proposals issued in 2009 will increase incentives for reduced risk appetite by requiring a more comprehensive coverage of risks (e.g. incremental default risk in the trading book and the introduction of a counterparty credit risk capital charge for derivatives, repos and securities financing) to be covered by higher quality capital, which is more costly. Moreover, the introduction of a harmonised liquidity framework will require banks to finance themselves using more stable funding sources on a structural basis. Finally, principles of sound compensation have been agreed that will discourage excessive risk-taking at the expense of long-term profitability and prudent risk management. These measures if taken together and properly implemented can significantly contribute to deterring short-termism and eliminating the flawed risk management practices we observed in the past.

Q28. What do you see as the most pressing issues in financial services legislation which remain to be completed after the Financial Services Action Plan?

One of the main lessons from the financial crisis is that the close interconnections existing between financial markets across the globe pose common problems that have to be addressed in an appropriate way with a concerted action. Therefore, as it has been already the case, the regulatory agenda for the EU should properly respond to the initiatives and recommendations being put forward at international level, and in particular by the G20, whose importance has emerged during the financial crisis. The action plans and recommendations by the G20 have already triggered a substantive amount of important work on the regulatory supervisory and financial stability arrangements from international bodies such as the Financial Stability Board and the Basel Committee on Banking Supervision for the banking sector which is of particular relevance in the EU context.

When considering the more important issues that should be addressed through regulatory initiatives we can distinguish between two main set of issues.

First, regulatory initiatives related to the enhancement of the prudential framework stemming from international initiatives. The completion of the Basel Committee reform programme, and the subsequent implementation in Europe, is critical to achieving a more resilient banking system that can support sound economic growth over the longer term, without impinging on the functioning of the market and economic recovery.

Moreover, within the context of international reforms I wish to underline the importance of three issues:

a) The need to reach an international consensus related to the solutions to the problems created by the systemically important financial institutions (SIFI's). There is a need to agree on the specific regulatory approach that should be adopted for the SIFIS and what should be the additional supervisory procedures in order to ensure an effective monitoring of their activities and risks. A recent ECB note on SIFIS, elaborated as a contribution to the Financial Services Committee, addresses comprehensively the main objectives for the regulation on SIFIS and the measures that could be adopted to reduces the risk of failure of a SIFI and to measure the consequence of such failures: "There are two objectives of regulation: (i) increasing the shock-absorbing capacity of institutions and lowering a SIFI's contribution to systemic risk, with special reference to the potential for contagion and spill-over effects; (ii) mitigating the moral hazard problem and the associated bail-out guarantee. Indeed, it can be argued that actions addressing one objective are instrumental in achieving the other as well.»

b) Addressing prudential risks presented by offshore financial centres and non-cooperative jurisdictions. Within the European Union, the 3L3 supervisory committees have carried out complementary mapping, identifying a consolidated list of non-cooperative jurisdictions, on which several EU supervisors have reported the existence of persistent problems. Nevertheless, the EU legal framework should address prudential risks presented by non-cooperative jurisdictions, in order to ensure all Member States deal with this issue in a harmonised and consistent way, in order to avoid regulatory arbitrage and to maintain the level playing field between financial institutions. The Capital Requirement Directive, the MiFID, as well as the Solvency II Directive, should include principles concerning activities in non-cooperative jurisdictions, restricting (or even forbidding) such activities whenever a jurisdiction does not cooperate with Member States competent authorities or if they obstruct the sharing of information on offshores subsidiaries for consolidated supervision purposes. Besides the Basel, IOSCO and IAIS Standards, it is also worth mentioning in this regard the recommendations concerning 'Consolidated know-your-customer (KYC) risk management', issued by the Basel Committee on October 2004, which establishes a comprehensive set of recommendations to deal with jurisdictions that have rigorous bank secrecy or data protection laws that prevent, or can be interpreted as preventing, the transfer of relevant information for risk management purposes. These recommendations foresee that if impediments to information sharing prove to be insurmountable, and there are no satisfactory alternative arrangements, the home supervisor should make it clear to the host that the bank may decide for itself, or be required by its home supervisor, to close down the operation in question. Furthermore, it is important to ensure that if the law restricts disclosure of information to "third parties", the head office or parent bank is excluded from the definition of a third party.
All these principles grounded on international standards and on work being developed at the FSB and EU levels, should include the establishment of a toolbox for prudential enforcement This toolbox could include a step-by-step approach, going from the intensification of dialogue and negotiations with problematic jurisdictions to the intensification of due diligence by institutions operating in those jurisdictions and/or requirements for higher own funds and/or restriction on activities or even closure of operations.

c) The development of more harmonised sanctioning regimes at the European level, in the light of recommendations of the "de Larosière Report" (recommendation 20): "The European Institutions should also set in motion a process which will lead to far more consistent sanctioning regimes across the Single Market. Supervision cannot be effective with weak, highly variant sanctioning regimes. It is essential that within the EU and elsewhere, all supervisors are able to deploy sanctions regimes that are sufficiently convergent, strict, resulting in deterrence. This is far from being the case now. The same exercise should be initiated with respect to supervisory powers in order to foster a coherent and effective supervision in the Single Market."

d) The need to conduct further work to promote standardisation of derivatives and support the use of central counterparties to clear derivative transactions, in particular in what regards credit default swaps.

Second, regulatory initiatives aimed to enhance the capability of the EU institutional framework for preventing and managing future crises. The greater interdependencies between national financial systems and the need to safeguard the process of EU financial integration require appropriate action at EU level to address the possible systemic impact of failing cross-border financial institutions. Therefore, the current reflections of the Commission for developing an EU resolution framework and addressing obstacles to the effective crisis management of EU cross-border financial institutions should be supported. The work should aim at the following priorities: (i) the development of a minimum toolkit for national competent authorities to address problems in an ailing bank, without necessarily resorting to public support, and when deemed appropriate, liquidate the bank without negative effects on financial stability; (ii) enhanced coordination and cooperation among national authorities, in particular when dealing with cross-border groups. In the shorter term, the legislative developments should include the harmonisation of Deposit Guarantee Scheme, foreseeing, inter alia, ex-ante and risked-based funding, complemented by credible ex-post funding to be activated when necessary. In complement to the pay-box function, the role of DGS in the resolution phase should also be considered. The establishment of a more comprehensive EU framework for crisis management and resolution would be essential to strengthen the single market for financial services as it will limit the incentives of national authorities to ring-fence the domestic components of an ailing financial institutions. However, this work would have to address tremendous challenges, such as the current differences in the legal regimes applicable to crisis resolution across Member States. I recall that the ECOFIN on 2 December 2009 invited the Economic and Financial Committee to continue its work on an EU policy coordination framework for crisis management, including the issue of burden sharing, and present concrete proposals to the Council in spring 2010.

I am sure the Eurosystem will contribute to such discussions in order to define an approach to burden sharing that would contribute to reducing moral hazard. It would be crucial to set out a consensus about the objectives to be reached and a roadmap of actions to be undertaken to achieve them.

Q29. How do you assess the current level of consolidation in financial services in the EU and what is your view on future prospects in this regard?

According to latest available structural indicators for the EU banking sector (i.e. 2008 figures), consolidation in the banking sector is continuing. However, this has also meant that market concentration is increasing, with the smaller countries generally having more concentrated markets than the larger ones. Domestic credit institutions continued to dominate the EU banking landscape and even increased their market share at the expense of foreign branches. Significant differences between countries continued with regard to the importance of foreign entities, with subsidiaries having a euro area parent being prevalent in the new EU Member States.

Merger and acquisition (M&A) activities increased in 2009 while remaining at low levels compared to the preceding ten years. Domestic and cross-border deals recorded the strongest increase. While in the past M&A deals were mainly driven by strategic considerations, such as realising economies of scale and entering new markets, many of the transactions completed in 2008 and in 2009 involved entities that had incurred significant losses or faced liquidity strains. At the same time, efforts to boost the capital position and cash reserves of certain credit institutions led to the spin-off of certain non-core activities, either in terms of business or geographical location.

In terms of the total value of M&A transactions, acquisitions considerably declined in 2009, with only domestic deals recording an increase.

It should also be noted that the participation of governments in credit institutions has constituted a significant shift in the ownership structure of some major credit institutions in the EU. However, due to the limited duration of government recapitalisation measures, it is expected that this shift in ownership will be temporary and that it will be reversed as the financial condition of these institutions, on a stand-alone basis, recovers.

As to the assessment of consolidation patterns, this has to be viewed in terms of its impact on the efficiency and soundness of individual banks, on competition in the banking sector and on financial stability in the financial sector more generally. To the extent that recent consolidation activities in the banking sector have contributed to increasing the profitability of banks and strengthening their resilience to shocks, they can be viewed as positive.

In assessing the future prospects for consolidation, an important consideration is the widespread consensus that the pre-crisis levels of banking sector leverage were excessive. Hence, it can be expected that as de-leveraging proceeds the profitability of the banking system (in terms of return on equity) will be lower return than in the recent past, at least at the medium term. Banks are therefore likely to look for new drivers of profitability. Consolidation may represent an attractive way to accomplish this objective for those banks which are emerging as the strongest players from the crisis, as acquisitions at relatively affordable prices will potentially be a way to achieve higher profitability in the long term – thanks to economies of scale. In that respect, M&A trends may be expected to continue after the crisis too. Mergers can also occur in the next few years as a rescue measure of troubled banks. As indicated, many of the reasons that validate the prediction that we will see further consolidation in the near future justify also the conclusion that this will lead to a more efficient and resilient banking system. On the other hand, the concentration of the sector may create more institutions «too big to fail» which makes it more pressing the need to implement the measures to address the problems that these institutions create.

D. Functioning of the ECB and democratic accountability and transparency

Q30: Shouldn't the different responsibilities of Board members change with time, in line with the changes occurred in the ECB's tasks and priorities?

The Executive Board of the ECB is a collegiate decision-making body; its functioning is based on the principle of collective responsibility, i.e. the Executive Board in its entirety is collectively responsible for its decisions and the overall functioning of the ECB business areas. While, for practical reasons, business areas report to individual Executive Board members who oversee and guide their work, all work units are placed under the managing direction of the Executive Board as a whole.

As has happened in the past the Executive Board may review, from time to time, the reporting lines to Executive Board members of work units and the preparation of its decisions. Such occasional adjustments in the individual responsibilities of Executive Board members contribute to strengthen the collegiate nature of the Executive Board. In this context, the composition of the portfolios of Executive Board members can change during their term of office. Any decision in this respect remains the sole responsibility of the Executive Board itself.

I attach myself great value to the collective nature of the Executive Board as this best ensures that various perspectives are reflected and that all the available expertise, experience and wisdom are appropriately taken into account when making decisions.

Q31. What system do you think is appropriate to ensure an equitable rotation of membership on the ECB-executive board also in terms of nationalities?

The pre-requisites for appointees to the ECB's Executive Board are established by the Treaty on the Functioning of the EU (Art 283.2) and the Statute of the ESCB and the ECB (Art 11.2):

- the members of the Executive Board "shall be appointed among persons of recognised standing and professional experience in monetary or banking matters";
- "only nationals of [euro area] Member States may be members of the Executive Board".

The Treaty thus establishes two requirements: "competence" and "[euro area] nationality". No other specification can be found in the Treaty as a determinant for the composition of the Executive Board of the ECB.

Appointments which would be based on considerations other than the above requirements may also conflict with the Treaty provisions on the ECB's independence. In the meetings of the ECB's decision making bodies all members participate in their personal capacity. The principle of independence entails that "neither the ECB, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Community institutions or bodies, from any Government of a Member State or from any other body." (Art. 130 of the Treaty, Art. 7 of the Statute). This Treaty provision is incompatible with the principle of national representation.

The final decision on appointments to the ECB's Executive Board is taken by the European Council (in which only euro area Members vote) upon a recommendation from the Council and following consultation of the European Parliament and the ECB. I trust that the above principles for the appointment of members to the Executive Board of the ECB are fully respected.

Q32. What is your view on the need to increase the diversity of backgrounds represented in the ECB board rather than relying solely on central bankers?

As mentioned in my reply to the previous question, the Treaty and the Statute are clear in stipulating that the members of the Executive Board "shall be appointed among persons of recognised standing and professional experience in monetary or banking matters".

It does not come as a surprise that central bankers fulfil this requirement. At the same time, this provision by no means excludes that appointment of candidates from outside the central banking community. As a matter of fact, in most central banks – and the ECB is no exception here - the background of members of the decision-making bodies is quite diverse and includes, for instance, professional experience in banking, academia and public administration.

You have seen from my own curriculum vitae that this also applies to me. In my view, the diversity of backgrounds of members of a collegiate decision-making body is an asset for the governance of the institution.

Q33. Could you elaborate on your views on the concept of democratic accountability with regards to the ECB and central banking in general?

To retain legitimacy, an independent central bank must be accountable to democratic institutions and the general public for its actions in the pursuit of its mandate. With the increasing recognition, especially in the past few decades, that independence is crucial for a central bank to deliver on its mandate, the nature of democratic accountability has also become more important. In this context, the accountability of central banks around the world has taken a number of different forms.

In the European Union, the ECB has a clear mandate and pursues it in an independent manner as provided for by the Treaty. Also foreseen in the Treaty is that this high degree of independence goes hand in hand with democratic accountability towards the European public and its directly elected representatives, that is, the European Parliament. A number of well defined ways have thus been established for holding the ECB accountable, not least with the regular appearances of the ECB's President before the Economic and Monetary Affairs Committee (ECON), and further appearances by the ECB Vice-President and other members of the ECB Executive Board. It is notable that the latter hearings represent a closer form of cooperation between the ECB and the European Parliament than is foreseen in the Treaty and this established practice is, in my view, a very positive element and also welcome by the EP. The ECB's accountability also entails precise reporting obligations [Art. 15 of ECB Statute]. Beyond the Annual Report presented to Parliament (and Council, Commission and European Council), the ECB is required to publish quarterly reports on the activities of the Eurosystem. The ECB decided to go beyond these Treaty requirements and report more frequently in the form of the Monthly Bulletin. Finally, apart from the consolidated Weekly Financial Statement, the ECB publishes a range of other task-related publications, including its bi-annual Financial Stability Report and its annual Financial Integration Report.

Q34. How do you judge the procedure used to replace ECB board members? Should ex ante democratic accountability and transparency not imply that the European Parliament at least be formally given the possibility to hear several potential candidates and give its opinion before Council makes the final decision about the nomination?

The procedure to select members of the ECB Executive Board is set out in Article 283 of the Treaty and Article 11 of the ESCB and ECB Statute. It has been agreed by all signatories in the most recent Treaty revision and is effective European law. As a candidate for the ECB Executive Board I am subject to that procedure and do not consider it appropriate to comment on its suitability.

Q35. What conclusions do you draw from the comparison between the transparency policies followed by the Federal Reserve Bank and by the ECB? Which alternative would you prefer: the publication of the minutes two weeks after monetary policy decisions were taken, such as practiced by the Fed and the Bank of England, or the press conference that immediately follows monetary policy decisions in addition to the instant publication on the internet of the reasoning behind the decision, such as done by the ECB?

A comparison across different approaches is a complex undertaking. One of the reasons is that central banks may have different needs owing to their specific histories and cultures, their policy objectives and other elements in their institutional frameworks. As a robust conclusion from available research, it has emerged that the way in which central banks nowadays take monetary policy decisions is much clearer and more transparent than in previous decades. Thereby, effectiveness of monetary policy has been enhanced on a global scale.

There are different ways of being transparent. For the following reasons I am convinced that the ECB's approach is one of the most advanced in the world. First, it is very transparent regarding the link between its monetary policy strategy and the reasons for its actions. Second, the Press Conference and the Introductory Statement are useful tools to disseminate important information to a heterogeneous audience. They provide interested parties (e.g. the general public, the media, and financial market observers) with a comprehensive set of relevant information on the ECB's monetary policy decisions. They aim at explaining the collective view of the Governing Council on the monetary policy stance. Third, the Introductory Statement and the Questions and Answers at the press conference are published in real-time. This feature would not be achievable with the publication of minutes. Overall, I regard the ECB's practice as demanding for all members of the Governing Council. I also believe that the ECB's approach is widely understood by now, and that the publication of minutes by other central banks makes perfect sense for them as well.

Q36: What's your opinion of the quarterly Monetary Dialogue between the European Parliament and the ECB President? Do you see any room for improvement in the Monetary Dialogue? Do the frequent discussions concerning the ECB's policies with other political actors harm the bank's independence?

The regular dialogue with the European Parliament is part of the democratic accountability of the European Central Bank to the European citizens and their directly elected representatives. In this context, the quarterly meetings between the President of the ECB and the Committee on Economic and Monetary Affairs represent a very important contribution to the public acceptance of the ECB's monetary policy. Together with additional appearances, also by other Executive Board Members, this interaction contributes to a deep and productive exchange of views. It also provides the ECB with a very valuable forum to explain its monetary

policy and to receive feedback. This extends to the EP Plenary where, inter alia, the ECB President presents the Bank's Annual Report. The quality of the dialogue between the ECB and the EP is of a very high standard. This has been acknowledged by both institutions on several occasions in the past.
I consider the regular exchange of information with other policy actors as a very important element of our policy framework in EMU. In this context, the ECB interacts with a number of European institutions on a regular basis. For example, the ECB is invited to the meetings of the Eurogroup and the ECOFIN Council. It regularly participates in the meetings of the Macroeconomic Dialogue. Interaction at technical level with the Commission and national governments also take place, for example, in the Economic and Financial Committee and the Economic Policy Committee of the EU. All these exchanges of views take place according to the provisions of the Treaty, thereby ensuring and always respecting the full independence of the ECB while at the same time supporting the proper functioning of EMU. They are therefore necessary and desirable precisely because they recognise the independence of the ECB.

Q37: Should the ECB be subject to a full scrutiny of the European Court of Auditors going beyond the concept of "operational efficiency" (Article 27.2 of the Statute of the ESCB and of the ECB)

The ECB's corporate governance is subject to a comprehensive framework of external and internal controls most elements of which are statutory in nature. The examination of the operational efficiency of the management of the ECB by the Court of Auditors is one important element of this control framework. This framework is complemented by regular reporting obligation to the European Parliament and the general public as well as judicial control by the Court of Justice of the European Union. All these elements have been set up also in the light of the guarantee of central bank independence. The independence of the ECB extends also to its financial resources.
From this it follows that there is no need to extend the control by the Court of Auditors beyond the concept of operational efficiency.

E. General

Q38. What do you see as the most important risks and challenges facing the ECB?

As regards main challenges and risks facing the ECB, let me restrict myself here to three of them:
The implementation of our exit strategy is an unprecedented challenge, with a need to ensure gradualism in the withdrawal of the ECB non-standard measures. Prevailing market uncertainty, however, means that determining the appropriate pace and scale of the exit continues to be a demanding task. I feel that the exit strategy measures taken to date by the ECB have been fully appropriate and justified by the assessment of economic and financial market conditions. Great care is needed going ahead, as the costs of errors can be very high, as the history of recovering from severe banking and economic crises has shown.
Another challenge I would like to highlight is the establishment and operation of the ESRB, for which the ECB will offer support. Intellectually, this task is challenging as new tools need to be developed for the assessment of macro-prudential risk, while

existing tools can also be used for this purpose. Furthermore, given overlaps between the ECB's General and Governing Councils and the new General Board of the ESRB as regards the composition of the both bodies, we need to ensure adequate and consistent communication. In particular, it needs to be emphasised that there is no trade-off between the objective of price stability and the support that the ECB can lend to other goals including financial stability. Finally, there are, for instance, organisational issues, such as how to embed the ESRB support function in the ECB's current organisation.

Finally, let me mention the challenge stemming from the pressures created by the existing imbalances in several member countries. This a problem for the countries themselves and for all European institutions with responsibilities in the management of monetary union but must involve also an active role for the ECB. As I recalled before, there is only one monetary policy for the euro area as a whole, but there is also a mission for the ECB in contributing to the analysis of competitiveness and divergences within the area helping the countries themselves to device and implement the appropriate policies. Being member of the European Unioncreates benefits for the countries concerned but also obligations. For members of the euro area, this applies even more so. These responsibilities need to be respected by all, to benefit the most from economic and monetary union in Europe. Policy actions need to be in line with European requirements. By this, I do not only mean living up to the fiscal rules in the Stability and Growth Pact, but also conducting structural policies that make Europe more productive, and hence more flexible. Likewise, private agents need to observe balanced behaviour in their cost and wage-setting behaviour. Insufficient progress and convergence in these areas not only concerns me as an enthusiastic supporter of Europe, it also affects the environment in which the ECB operates, and therefore is also a concern to me as monetary policy-maker.