Jean-Claude Trichet: Completing Economic and Monetary Union

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the Gala Dinner of the State of the European Union conference “Revitalising the European Dream: A Corporate View”, Brussels, 28 June 2011.

*   *   *

Ladies and gentlemen,

Thank you for inviting me to this conference. The theme to which it is dedicated is especially relevant today, when we have to draw all the lessons from the worst financial crisis since World War II.

These days, “Europe” and the benefits it brings have come to be taken for granted. Thanks to the success of European integration, the threat of war has become a memory of the past for many Europeans, in particular the younger generation.

This makes it all the more urgent to develop a renewed vision of the kind of Europe we want and indeed need – a vision that is easily understood and shared amongst EU citizens.

Each generation needs to affirm its commitment to Europe.

As Pierre Werner once observed, *“it is necessary that even those born well after the 1950s and 1960s realise that the European Union has not come about by chance, but that it is based on the fundamental necessities of life amongst the peoples of Europe”*[1].

Thankfully, these “fundamental necessities of life” – especially in the economic sphere – still seem to be felt and understood by the people in Europe. When asked, in the Eurobarometer surveys, which issues the European institutions should focus on in the coming years, Europeans believe that priority should be given to economic and monetary policy (37% in the EU and 41% in the euro area).

More than three out of four Europeans (78%) agree that measures to reduce the public deficit and debt in their country cannot be delayed.

More than three quarters of respondents (77%) consider that stronger coordination of economic and financial policies, as well as closer supervision of financial institutions would be effective in combating the crisis. The idea of initiating reforms to benefit future generations attracts equally strong support.

Revitalising Europe

Revitalising Europe means bringing the reality of today’s Europe, of its institutions and policies, closer to these wishes and concerns of the EU citizens.

A Europe of stability and responsibility where the burdens of today’s adjustments are not shifted onto future generations.

An open and flexible Europe fostering education, entrepreneurship and innovation, with ample employment opportunities and a high standard of living.

A Europe that fully brings its economic and political weight to bear in an ever more globalised economy.

[1] «Il est nécessaire que même ceux qui sont nés bien après les années 50 et 60 se rendent compte que l’Union européenne n’est pas un coup du hasard, qu’elle se fonde sur des nécessités fondamentales de la vie entre les peuples de l’Europe » (On 11 December 1997, on the eve of the Luxembourg European Council).

There is a good basis for all of this – we can indeed take pride in our past achievements.

Having served as a member of the Governing Council of the ECB since the launch of the euro and as its President for almost eight years now, let me say that we have accomplished a lot:

For example, companies in the euro area do not have to worry about price stability – I will come back later on this issue – and possible devaluations in the countries of their main trading partners. They face lower transaction and hedging costs. There is more price transparency and more ample access to finance, in general.

Since the start of the euro, employment in the euro area has risen by over 14 million, compared with about 8 million in the United States. Adjusted for population growth differences, growth per capita in the euro area has been almost the same as in the United States over the past decade, at about 1% per year in terms of GDP per capita growth.

Trade among euro area countries has also risen strongly. The value of exports and imports of goods within the euro area increased from about one quarter of GDP in 1998 to one third of GDP in 2007, with trade within euro area countries representing about a half of the total euro area trade.

Economic and Monetary Union

The key to understanding the current challenges in the euro area is the specific construction of Economic and Monetary Union.

The coexistence of an achieved monetary union – the single currency, the single monetary policy and the Eurosystem with the ECB at its helm – and of a largely decentralised economic pillar.

Indeed, Member States are responsible for their fiscal and economic policies, but are called to treat them as a matter of common concern. Those policies are subject to a European governance framework to ensure that they are fully compatible with the requirements of a single currency.

Our governance framework largely relied on the self-discipline of national governments, with hard constraints at the EU level only in those few cases where hard rules were supposed to apply.

We had assumed that countries had sufficient incentives to “keep their house in order” and thereby contribute to the common good of the euro area. An overly narrow interpretation of the principle of subsidiarity also shielded national economic policies from what was seen as undue European interference.

The experience of the first twelve years of EMU suggests that the limits of *de facto* soft policy coordination have largely been exhausted, with the interdependencies inside a monetary union calling for a stronger euro area dimension.

Let me now take a closer look at the two EMU pillars separately.

The “M” of the EMU

The “M” of the EMU, or the monetary pillar, has performed well.

The ECB has a clear assignment: to deliver price stability, which is defined as an annual inflation rate below but close to 2% over the medium term. And over the 12 years since the launch of EMU, the average annual inflation rate in the euro area has been 1.97%.

This is the best result of a major central bank in the euro area for any such period of 12 years, over the last 50 years.

We achieved this during challenging times. Over the years, we have had to cope with the bursting of the dot-com bubble, the aftermath of the events of 11September 2001, the jump in oil prices to $147 per barrel in 2008, rising prices of food and commodities, and then of course the worst financial and economic crisis since the Great Depression.

Yet throughout these very different economic shocks – which could have had either inflationary or deflationary consequences – citizens and market participants in the euro area have remained confident in our commitment. Inflation expectations have been firmly anchored in line with our definition of price stability.

The "E" of the EMU

It is the "E" of the EMU, where progress is needed.

Already the 1989 Delors report stated that *"an Economic and Monetary Union could only operate on the basis of mutually consistent and sound behaviour by governments and other economic agents in all member countries. (…) Uncoordinated and divergent national budgetary policies would undermine monetary stability and generate imbalances in the real and financial sectors of the community."*

What does this mean in practice?

It means improving economic governance.

It means strengthening the rules to prevent unsound policies.

And it means to prohibit individual countries from pursuing policies that can harm themselves and the euro area as a whole.

For this reason, I have called, in the name of the Governing Council, on the Commission, the Council and the European Parliament to be very ambitious in reinforcing economic governance in the euro area.

We have called for a "quantum leap" in governance, for a substantially deepened economic union.

Essential reforms

In the short-term, we have to tackle the most urgent issues by implementing the structural adjustment programmes that are currently underway.

The new economic governance framework that is currently being negotiated needs to be agreed and implemented in full and without delay.

We must get the institutional framework for the medium-term right.

The two EU co-legislators and the Commission have been negotiating the new economic governance package during the preceding weeks.

The European Parliament has confirmed its position at last Thursday's plenary vote. The ECB particularly welcomes the strong message that is sent as regards the fact that the Stability and Growth Pact's procedures have to be made more automatic. Our past experience in applying the Pact, especially after weakening of its core provisions in 2005, have amply demonstrated that a reform of these procedures has to be a *sine qua non* of a determined response to the current crisis.

In this context, the Governing Council of the ECB regrets that the European Council did not decide to espouse the European Parliament's views on this issue at the end of last week. This is an issue of key importance for the ECB. We consider that an essential progress in decision-making procedures in the Council is to make them more automatic.

The extension of reverse qualified majority voting to the preventive arm of the Pact, which the European Parliament rightly insists on, is not about a perceived loss of sovereignty. It is a mechanism that would allow all Member States to protect themselves better from the harmful effects of unsound fiscal policies.

Since the very beginning of the discussions on the reform of economic governance in May 2010, the ECB has asked for greater automatism in the decision-making procedures to limit the room for discretion. This is a major component of the “quantum leap” that we have called for.

Had the Council had less room for manoeuvre in suspending or halting fiscal surveillance procedures in the years preceding the crisis, some of the euro area countries would not be facing as severe a sovereign debt crisis today.

However, this was not the entire story – surveillance instruments were lacking altogether as regards the build-up of competitiveness losses and of macroeconomic imbalances, which have made any solution to fiscal problems even more challenging.

Therefore, the ECB has also called for a fully-fledged surveillance procedure for competitiveness indicators and for macroeconomic imbalances. As a matter of fact, we have been pointing to the risks associated with competitiveness losses since 2005 and insisting on peer review and mutual oversight. The new procedure needs to be focused on the countries with large competitiveness losses and high indebtedness, since it is those countries that pose a potential threat to the functioning of EMU.

In the short term, all parties have to take their responsibilities and agree on an ambitious governance package with two pillars – surveillance of fiscal policies and surveillance of macroeconomic policies, sending out a clear message to strengthen the economic policy framework that has been dented during the crisis. We urge a swift and ambitious completion of the legislative procedure to bring about certainty on this new framework.

An additional element of stronger economic policy coordination for competitiveness and convergence surveillance in the euro area is the newly agreed Euro Plus Pact. The ECB supports the four goals of this Pact, namely to foster competitiveness and employment, to contribute to the sustainability of public finances and to reinforce financial stability.

But we have also insisted that the Euro Plus Pact must be more than declarations. It must be followed up with concrete action. The ECB therefore welcomes the fact that the European Council last week called on the participating Member States to make their reform commitments more concrete, including specific timelines, to enable easier measurement of progress and benchmarking.

Single market

Furthermore, let us not forget that the euro area of the 17 countries is participating actively in the larger Single Market of the 27 member countries of the European Union.

The Single Market forms an integral part of the wider Europe 2020 strategy for smart, sustainable and inclusive growth. The governance framework of this strategy underpins the wider surveillance efforts of the economic pillar of EMU. The first experience as part of the so-called European Semester is approaching its final stages, with the European Council’s endorsement of the proposed recommendations for individual Member States last week.

The EU Single market offers a unique businesses environment with direct access to over 500 million potential business partners, employees and consumers with relatively high purchasing power. The Single Market has not been at the centre of the EU political priorities for quite some time and there have even been protectionist tendencies.

I, therefore, strongly support the initiatives aimed at re-launching the Single Market to address the prevailing structural challenges faced by the EU economy. The Single Market is at the core of the Union's growth agenda. A widening and deepening of the Single Market should be viewed as an opportunity to raise the "speed limit" of the economy, which is highly warranted in the aftermath of the impact the financial crisis had on the European economy.

Moreover, completion of the Single Market is an essential ingredient of the required quantum leap towards a deeper economic union that is commensurate with the degree of economic integration and interdependency already achieved through monetary union. EMU has led to a strengthening of trade integration and competition within the Single Market by enhancing market access, reducing the costs of cross-border activities and increasing price transparency.

At the same time, a well-functioning Single Market is pivotal for the smooth functioning of EMU. It allows for swift and market-based adjustment in case of shocks and facilitates the correction of economic imbalances.

A well functioning Single Market also requires proper design and implementation of financial sector policies. In this respect, the establishment of a new EU supervisory architecture to introduce genuine macro-prudential supervision and to strengthen the micro-prudential oversight at the EU level was a prerequisite for enhanced financial stability arrangements.

The establishment of the European Systemic Risk Board and the European Supervisory Authorities is an important milestone in providing the appropriate incentives to avoid excessive risk taking in the financial sector and to promote a level playing field in support of beneficial financial integration within the monetary union. Establishment of an EU framework for crisis management is an important complementary element of the new supervisory framework that still needs to be put in place.

Conclusion

This is a large agenda already. What more would be needed for EMU in the longer term?

I have sketched out in my speech in Aachen earlier this month some elements that in my view would warrant consideration in the design of a longer-term vision for Europe.

Developing these elements in more detail would, however, be the topic of another speech.

Ladies and Gentlemen,

I thank you for your attention.