Jean-Claude Trichet: Tomorrow and the day after tomorrow – a vision for Europe

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the Humboldt University, Berlin, 24 October 2011.

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Ladies and gentlemen,

It is a great pleasure to be invited to speak here at the Humboldt University this evening. One can only be honoured to be in the university of Hegel, Heinrich Heine and the Nobel prize-winning physicists Albert Einstein and Max Planck – not to mention 27 other laureates. But it is with the ideas of the university's founder – Wilhelm von Humboldt – that I would like to begin my remarks.

As a Frenchman who has lived in Germany for the past eight years, I note with interest that the mother of the university's founder – Marie-Elisabeth Colomb – came from a French Huguenot family who also made that eastwards move. Her family had emigrated to Berlin following the Revocation of the Edict of Nantes, a reminder that European integration is a process that has been with us for centuries.

Wilhelm von Humboldt himself was deeply engaged with the question of how to create the conditions for individuals to flourish within a society. His answer involved removing the conditions for mutual harm.

In some ways, this speaks to the challenges of European integration.

The individual Member States of the European Union (EU) also seek to flourish. Their actions are interdependent and can both benefit and damage each other. Removing the potential for mutual harm is essential for collective prosperity.

This dialectic between the individual and the community is at the core of the European project. It is the dialectic between the individual nation states and the community of nations. And it presents some of Europe's most fundamental challenges.

I would like to reflect today on how to address these challenges – to look forward and offer a perspective of where Europe could go.

In particular, I would like to develop three propositions.

First, while the reasons for European unity have often been presented as deriving from past conflicts and past divisions, forward-looking motivations are in my view decisive.

The unique construction of Europe – with strong local identities and large, integrated markets – is a source of great strength in the new, globalised world we face. It allows Europeans to plant deep roots and build strong communities. At the same time, we can fully benefit from economies of scale and the free flow of trade and investment.

For this reason, European integration is profoundly in the interests of all Member States and deeply connected to their *future* prosperity.

Second, for Europe to realise fully its future potential, it needs the right rules and the right institutions.

Europe requires a solid form of governance to ensure that the actions of individual countries are oriented towards the common good. Our current arrangements have not yet fully met this standard. They are now being improved. It is a continuous process which will call for Treaty changes if necessary.

As this process will take time, we need to start planning today for the Europe of tomorrow and the Europe of the day after tomorrow.

Third, the underpinning of a more integrated Europe is the emergence of a true European public debate.

As one would say in German, die Schaffung einer europäischen Öffentlichkeit.

Europeans today are highly interconnected via economic and social linkages. Yet our fragmented national public discourse does not necessarily permit citizens to understand fully these connections.

A true European public debate would help us deepen our interest in each other, bridge our linguistic differences and care more about what is happening across our borders.

These are the three main themes on which I will focus tonight.

But before I talk about the Europe of the future, I would like to talk about the Europe of today. To reflect on the relationship between member countries and Europe. And to touch on the challenges we collectively face in tackling the crisis.

1. Europe and Germany

Building deeper union between France and Germany in the service of Europe has been an important theme of my own working life. In this time, I have been profoundly influenced by the German commitment to a stability culture.

In the 1980s, I was seen in my own country as the strongest advocate of the "franc fort" policy. This policy was designed to be part of the modernisation of the French economy through a "competitive disinflation" policy.

In the 1990s, I worked side-by-side with Hans Tietmeyer and Horst Köhler to contribute to the foundations of the euro in the Maastricht Treaty. This work was to ensure that, among other things, the European Central Bank (ECB) would be based on the principles of independence and the pursuit of price stability.

Then in 2003, I had the honour of moving to Frankfurt to become President of this institution.

It was a great personal satisfaction to join an institution that embodied my deep-seated beliefs in central bank independence, price stability and economic discipline.

Over this period I have developed a strong admiration for Germany and its people, and also for the way that Germany conducts its economic policies.

The German economy has often been thought of as the engine of the European economy. But less than 10 years ago, Germany was seen by some observers as the "sick man of Europe".

Let me cite some books and newspaper articles from that time:

> *"Can Germany be saved?"*, asked one of this country's most well-known economists in 2003, noting that *"Germany provides something of a case study of what not to do in designing a prosperous future"*.
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> *"How the mighty are fallen",* said a major international magazine also in 2003, well representing the mainstream economic analysis. *"After the German economy was seen as an exemplary model of successful capitalism for decades*," the magazine went on, *"today it is Germany that economists point to with a mixture of contempt and alarm."*
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> *"Vom Meister zum Mittelmaß",* wrote a major German newspaper in 2005, speaking of *"absteigende Staaten wie Deutschland, die in ihrer Bedeutung schrumpften und ihren Haushalt nicht in den Griff bekämen."*

Thankfully, these gloomy forecasts proved mistaken, and today, Germany is in the lead in rebounding from the crisis.

Since the trough of mid-2009, German real GDP has grown by 6.9% compared with the euro area as a whole by 3.8%. Employment in Germany has increased by 2.1%. Exports have grown by 25.6%. This performance is no accident. Neither is it based on cyclical, unsustainable factors. It is the result of sound fiscal policies, permanent attention to unit labour costs, and bold reforms that have been rigorously implemented over a prolonged period. And it sets an example that is very important for the current situation.

First, it demonstrates how sound policies can lead to prosperity within economic and monetary union.

By encouraging industries to embrace the opportunities of globalisation. By maintaining technological excellence. By prioritising cost and price competitiveness. And by ensuring flexibility in the labour market.

Second, it proves that it is possible to regain competitiveness within monetary union.

Germany after the post-unification boom had a very serious competitiveness problem itself. It took a sustained effort to become competitive again.

This gives encouragement to euro area countries that have lost competitiveness and now must regain it. It also underscores the fact that the adjustment effort must begin immediately.

But there is also a third lesson from the German example.

Would the German recovery have been possible without the euro and Germany being in the euro area? Without Germany benefiting from a vast single market of the size of the United States with a highly stable currency?

The German recovery has taken place in the context of the best inflation record achieved by a major central bank for over 50 years. The ECB has delivered an average rate of inflation of 2.0% since beginning operations in 1999. In Germany it is even lower with an average yearly inflation rate of 1.57%.

Such a low rate of inflation over a comparable time period is actually the lowest in Germany for over 50 years. Moreover, expectations of future inflation remain firmly anchored in line with our definition of price stability.

Financial markets and euro area citizens expect the ECB to deliver on its mandate. The German public can rely on our steadfast commitment to do so.

The euro has extended the zone of monetary stability to Germany's main trading partners in the euro area. As more than 40% of Germany's exports go to other euro area countries, this is very important for German prosperity. The stability of the euro has also helped German companies remain competitive vis-à-vis the rest of the world.

2. Europe and the crisis

Let me now turn directly to our current challenges. As you are all well aware, we continue to face the most serious economic and financial crisis since World War II. Tackling the crisis has required unprecedented action from public authorities to maintain economic and financial stability.

Inevitably this has produced diverging views. This is not surprising. The euro area is responding to events of historical importance and it naturally takes time to forge consensus on the right way ahead.

But it is very important that people do not misconstrue these debates. They are about policies, not about principles, because in the euro area our principles do not change.

Our principles are the foundations on which we rest. Stability. Responsibility. Independence.

But our policies must adapt. No two crises are the same. It is precisely because we want to defend and reinforce the principles we cherish, that we have to shape our policies appropriately.

I am fully aware that in this country people have genuine concerns about the single currency. They seek assurance that it remains a community of stability. That it is founded on rules and responsibilities. And that the rules are respected and the responsibilities are taken seriously.

I would like to use this occasion to explain the way the Governing Council of the ECB is deciding on monetary policy.

Our standard measure for fulfilling our mandate of maintaining price stability – avoiding both inflation and deflation – is interest rate policy. But effective interest rate policy requires that our policy decisions are transmitted to the real economy. If that is not the case, our monetary policy cannot achieve its objective.

In this transmission, both banks and financial markets play an important role. They are crucial for the financing of the real economy – of firms and households. Yet the crisis has damaged banks and at times severely disrupted the functioning of financial markets.

Addressing these problems needed to be done through non-standard measures. The ECB has decided such measures, for monetary policy reasons, since the very start of the global crisis. It has been offering liquidity to financial institutions at a fixed rate and with full allotment. It has also provided this liquidity over an extended period of time, up to 12 months, so that the euro area banking sector, Germany's banks included, could continue to be as correct as possible a vehicle for the transmission of our monetary policy.

With additional liquidity demanded by the euro area banks, our balance sheet has expanded during the crisis. But we have been prudent. Our balance sheet has expanded by about 80% since the beginning of the crisis. Only for the sake of comparison the balance sheet of the Federal Reserve increased by about 230%, that of the Bank of England by 205%, and that of the Swiss National Bank by 235%. The crisis hit all of the economies concerned, but you can see that all our non-standard policies have been measured.

Of all our non-standard measures, the policy of full liquidity allotment at fixed rates has been the most important one in my view. Yet it is the bond market interventions that have received the greatest attention, and the most scrutiny.

But just as our measures of enhanced credit support have been necessary to ensure that banks continue to extend credit to the real economy, our bond market interventions have been necessary to help foster a more appropriate transmission of our policies to the real economy. The government bond markets are crucial for our monetary policy transmission. They largely determine the prices of loans and mortgages and thus affect, indirectly, the transmission of monetary policy to all firms and households.

The ECB's government bond market interventions are not inflationary. Unlike the bond purchase programmes of other major central banks our aim is not to inject additional liquidity. We actually absorb all liquidity injected by these purchases on a regular basis – euro for euro, week by week.

There is no fuelling of money growth in the euro area. M3 growth is less than 3% currently and inflation expectations have remained firmly anchored by all standards.

So let me emphasise this point. It is very important to understand that all the ECB's policy decisions during the crisis have been made fully in line with our mandate to maintain price stability.

They have been taken in full independence and we have established a solid track record for our independent decisions. Both inflation and inflation expectations in the euro area demonstrate the value of independent deeds, not just words.

Last week in Frankfurt, at the occasion of my official farewell as President of the ECB, Prime Minster Juncker, the longest-serving prime minister in Europe and chair of the Eurogroup, said that discussions of government pressure on the ECB lacked any basis in fact, that such pressure would have been completely futile and that the ECB always acts completely independently.

3. Europe and the future

I have talked about where Europe has come from. Let me turn now to where Europe is going.

When people seek a justification for European integration, there is a tendency to look backwards.

European integration has banished the spectre of war from our continent, is always stressed. European integration has delivered the longest period of peace and prosperity in European history.

This perspective is entirely correct. But it is also incomplete.

There are many more reasons for striving towards "ever closer union" in Europe today than there were in 1945. And these are entirely forward-looking.

65 years ago the distribution of global GDP was such that Europe had only one role model for its single market: the United States of America.

Today, Europe is faced with a new global economy, reconfigured by globalisation and by the emerging economies of Asia and Latin America.

It is a world where economies of scale and networks of innovation matter more than ever. By 2016 – that is, very soon – we can expect the euro area in terms of purchasing power parity to be below the GDP of China and over and above the GDP of India. Together, these two countries would represent around twice the GDP of the euro area.

Over a longer horizon, the entire GDP of the G7 countries will be dwarfed by the rapid development of the systemic emerging economies.

Europe has to cope with a new geo-political landscape very profoundly reshaped by these emerging economies.

And Europe is also faced with new global challenges, such as climate change and migration, where effective solutions are possible only at the European and international levels.

In this new global constellation, European integration – both economic and political – is central to achieving prosperity and influence. For an outward-looking, export-oriented country like Germany, this is profoundly in its interests.

The challenge is to set the correct path for European integration. Getting this right is essential to realise fully our continent's tremendous potential. Let me therefore lay out a vision for the Europe of tomorrow.

The Europe of tomorrow

The creation of Europe's economic and monetary union is unique in the history of sovereign states. The euro area constitutes a "society of states" of a completely new type.

Like individuals in a society, euro area countries are both independent and interdependent. They can affect each other both positively and negatively.

Good governance requires that both individual Member States and the institutions of the EU fulfil their responsibilities.

First and foremost, every country in the euro area needs to keep its own house in order.

This means responsible economic policies on behalf of governments and rigorous mutual surveillance of those policies by the Commission and Member States – going beyond the indispensable surveillance of fiscal policies to encompass all aspects of the economy.

In a society, the institutions of law enforcement can ultimately compel a citizen to abide by the rules. In the euro area, our framework based on surveillance and sanctions depends on the willingness of offending states to comply.

I am aware that many observers wonder what can be done if a Member State simply cannot deliver on its promises.

That is why, when I had the deep honour of receiving the Karlspreis, I suggested a new approach to the policing of economic governance.

For countries that lose market access, the current approach of providing aid against strong conditionality is justified. Countries deserve an opportunity to put the situation right themselves and to restore stability.

But as I suggested in Aachen, this approach should have clearly defined limits. A second stage should be envisaged for a country that persistently fails to meet its programme targets.

Under this second stage, euro area authorities would gain a much deeper and more authoritative role in the formulation of that country's economic policies.

This would move us away from the present concept where all decisions remain in the hands of the country concerned. Instead, it would be not only possible, but in some cases compulsory, for the European authorities to take direct decisions.

Implementing this idea of the second stage would evidently require a Treaty change. It would also imply a new concept of sovereignty. This is necessary given the complex interdependence that exists between euro area countries. And it is ultimately in the interests of all citizens of the euro area.

In my view, it was important to launch such reflections as soon as possible. I am very happy that the European Council, at its meeting yesterday in Brussels, has indicated in its conclusions: "The European Council notes the intention of the Heads of State or Government of the euro area to reflect on further strengthening of economic convergence within the euro area, on improving fiscal discipline and deepening economic union, including exploring the possibility of limited Treaty changes."

The Europe of the day after tomorrow

Let me now look even further into the future. A vision that can stabilise expectations needs to address not just tomorrow, but also the day after tomorrow. And as it takes time to implement such a vision, we must start thinking about it today.

It is my firm conviction that the Europe of the day after tomorrow will be of an original type – a new type of institutional framework.

In Aachen, on a personal basis, I began to reflect on some elements of this new possible framework.

I asked the question: with a single market, a single currency and a single central bank, would it be too bold to envisage a ministry of finance of the Union?

This European finance ministry would, first, oversee the surveillance of both fiscal policies and competitiveness policies, and when necessary, have responsibility for imposing the "second stage" I just described.

Second, the ministry would perform the typical responsibilities of the executive branches regarding the supervision and regulation of the EU financial sector.

And third, the ministry would represent the euro area in international financial institutions.

Since my Karlspreis address, it seems to me that the case for such an approach has strengthened.

I now hear leaders calling for a Treaty change to create stronger economic governance at the EU level. I hear euro area citizens calling for better supervision of the financial sector. And I know that our partners in the G20 look to Europe as a whole for solutions, not to individual Member States.

Increasingly, it seems that it is not too bold to consider a European finance ministry, but rather too bold not to consider creating such an institution.

This finance ministry would be only one element of the European future institutional framework. Exactly how these new institutions would eventually evolve one cannot say. As Jean Monnet once wrote: *« Personne ne peut encore dire aujourd'hui la forme qu'aura l'Europe que nous vivrons demain, car le changement qui naîtra du changement est imprévisible »*. [1]

We have several federal or confederal institutional frameworks in today's world. To name only a few, the United States of America, the Federal Republic of Germany and the Swiss Confederation. The European Union is unique in its past history, in its present nature, in its future ambition. It will have to invent its own concept.

But one could imagine that in the future European institutional framework, the Council might evolve into the Senate of the Union, the European Parliament into the lower house, the Commission into the executive and the European Court of Justice into the judiciary – each time for the part of sovereignty that is shared.

And I have no doubt, taking into account the long and proud history of the European countries, that "subsidiarity" will play a major role in the future Europe – very significantly more than in the present models of federation.

As I said, these are personal remarks of a European citizen. The future of Europe is in the hands of its democracies, in the hands of the people of Europe. Our fellow citizens will decide. They are the masters.

In any case, whatever the future institutions of Europe will be, an essential element would be the emergence of a truly pan European public debate. As Europeans we connect deeply with our nations, traditions and histories. These are Europe's roots. But we also need to extend our branches more widely.

To do this, the Euro area needs media, in the broadest sense of that word, that allow citizens to take a deeper interest each other. Media that provide regular information on events beyond national borders. Media that permit citizens to debate and exchange. And media that are not constrained by language barriers. All we need is a pan European public debate, a *gemeinsamer öffentlicher Raum,* a *débat publique pan-Européen* that allows Europeans to appreciate the wider community of which they are part – a community where their interests are increasingly shared and their lives more interdependent than ever before.

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Let me draw to a close.

Twenty years ago, in 1991, my friend Hans Tietmeyer, the former President of the Bundesbank, said that "monetary union is not just a technical matter. It is in itself, to some extent, a political union".

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1 "Nobody can say today what will be the institutional framework of Europe tomorrow because the future changes, which will be fostered by today's changes, are unpredictable."

This condition creates mutual responsibilities.

We see that a challenge in one country can become a challenge for the euro area as a whole. Addressing it requires strong responses from all Member States, including Germany, and from EU institutions.

The global crisis has called into question the overall economic and financial strategy of major advanced economies. All have weaknesses in their economic systems. Not surprisingly, the main weakness for Europe was the nature of its institutional framework – in particular, that its economic and fiscal governance was not commensurate with the interconnectedness of economies sharing a single market and a single currency.

The question is how to confront those obstacles. We should not look back. We must look forward – to the opportunities of Europe for our collective betterment; and to the potential for every country to be stronger and more prosperous in a well-functioning union.

As far as the ECB is concerned, its Governing Council will continue to anchor solidly price stability and confidence in Europe – stability and confidence for 17 countries and 332 million fellow citizens who have decided to unite closely with a single market and a single currency. As Konrad Adenauer said in Aachen 57 years ago: “Gerade wird man die Mahnung verstehen, dass Europa uns heute Schicksalsgemeinschaft ist. Dieses Schicksal zu gestalten ist uns übergeben”. “Above all, people will understand the call: that Europe, for us today, is a community with a common destiny. It’s up to us to shape that destiny”.

Thank you for your attention.