Benoît Cœuré: Towards a political convergence process in the euro area

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Interparliamentary Conference "Towards a Progressive Europe", Berlin, 16 October 2015.

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Summary

The effectiveness of the ECB's action rests on the "M" in the EMU being kept free from political interference. But for this to be secured in a lasting way, we need to further develop the "E", i.e. the economic union.

In the past decade, intermediate solutions to save the euro area were found, but left the EMU still vulnerable to future crises. Therefore, we need to define a new convergence process, involving converging economic structures and more integrated markets. This should be complemented by fully legitimate institutions with the right instruments to intervene if the consensus is not respected.

This new convergence process will lead to higher resilience against economic shocks on a national level and European level, via internal and euro-wide adjustment mechanisms. And it is a prerequisite before discussing a layer of fiscal stabilisation at the European level, which would protect monetary policy from bearing too much of the stabilisation burden.

But such a new convergence process cannot be a technical exercise. For convergence to be lasting and to secure the buy-in of citizens and Member States, such a process needs to be political in nature. This requires a revived political narrative for euro area integration, and a coherent European social contract that brings out the best in each national social contract.

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Honourable Members of Parliament,

Ladies and gentlemen,

Dear Group Vice-President Carsten [Schneider],

Many thanks for your kind introduction and for having me here today. I am glad to see that Parliaments are at the forefront of the debate on the future of Economic and Monetary Union or EMU. You may wonder what an unelected central banker has to say about the political foundations of EMU. After all, the European Central Bank (ECB) is not a political institution. Indeed, for our work to be effective, the "M" in EMU must be kept free from political interference. But to secure this in the long term, we need to develop the "E", so economic union, further. I will argue today that the political dimension of economic union will be crucial.

Moving forward with passion and perspective

Almost, one hundred years ago Max Weber famously described politics as "a strong and slow boring of hard boards which takes both passion and perspective" [1].

The board we want to drill into today, the future of EMU, is certainly one of the hardest and thickest, requiring not only passion but also an ability to cope with frustration – had you asked me in July and August about my passion for attending lengthy Eurogroup meetings, night-long

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[1] See Weber, M., "Politics as a Vocation" in Gerth, H.H. and Wright Mills, C. (eds.), "From Max Weber: Essays in sociology", Routledge, 1991.

negotiations and teleconferences, I would not have shown great enthusiasm; all too often, we lose perspective of what we want to achieve.

First, some people simply want EMU to be dismantled – either in its entirety or at least where their country is concerned. They can be found on both the left and right of the political spectrum. This is what I would call the "ostrich fallacy". As a euro area country, you may theoretically give up your voice in the euro project. But you cannot forgo interdependence. We are too closely interlinked and frankly too small individually to solve problems alone in the face of globalisation. Sticking our heads in the sand will not make these facts go away. This was why we moved from fixed exchange rate regimes – which were more volatile, asymmetric and unpredictable than what we have today – to a single currency. And this single currency, as recent months have once again shown, is here to stay.

Second, other people think that we can continue to muddle through with the architecture and arrangements that we have today, occasionally propped up by crises. They recall how much has been achieved over the last half-decade to shore up the construction of EMU, and they are right. But the developments over the summer, the state of our economy and the apparent problems implementing the new, recently agreed rules all point to the fact that what we have today is not enough. We need to go beyond the quick fixes and intermediate solutions that were necessary, but insufficient to make EMU strong enough to weather future crises and to be the foundation for sustainable growth.

Third, there is the temptation to view a transfer of all important economic policy functions to the European level as the "silver bullet solution or, as Charles De Gaulle once said, to jump up and down on your chair like a goat kid bleating "Europe! Europe!". The argument goes as follows: If only Europe could help formulate the right policies and actively enforce those policies, the continent would prosper again. And once our policy output improved, this would give the European project the legitimacy it had partly lost in the eyes of citizens in recent years. Even we at the ECB are not immune to this temptation. But it would be unrealistic to cling to it too much for this is not an idea that European citizens are prepared to accept today.

So, today I want to propose that we move forward without losing perspective.[2] In particular, and in my view, this means moving forward *economically* and *politically* at the same time; moving towards more common decision-making regarding our economic policies while at the same time increasing the European legitimacy of this decision-making.

A political narrative for EMU

We should never forget that, at its heart, European integration has always been a political project. When six countries decided in 1951 to unify their coal and steel markets, this was fuelled by the deep conviction that binding these countries together with a common destiny was the best way to avoid another war. Europe was never first and foremost about economic functionalities and necessities. In the same spirit, I am convinced that to take the next step in economic integration, we will need to revive the political narrative for European integration.

However, when we look at the past decade, we can appreciate that the need to move ahead was a direct consequence of the crisis. The European Stability Mechanism and its precursors – beginning with the bilateral loans to Greece in May 2010 – were established in response to an imperative imposed by the urgency of the situation; yet they have changed the nature of EMU forever and have emphasised how deeply interconnected we are.

The steps that came next – the strengthening of the governance framework, the fiscal compact, banking union – were the first manifestations of this change, and I know that many of you have actively contributed to these achievements. But they still very much followed the functional

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2 See Coeuré, B., "Is eurozone governance fit for purpose?", keynote speech at a dinner organised by the Centre for European Reform, London, 30 January 2014.

narrative of immediate crisis management and prevention, a narrative of functional necessity and not so much of political choice.

These steps were essential for shoring up EMU and for showing the world that we were willing to do what is necessary. However, the basic set-up in terms of the allocation of competencies under the Maastricht framework has remained unchanged: labour market legislation, social protection schemes, tax policies, many aspects of the product markets, and the overwhelming majority of business environment factors, such as judicial systems, have remained within the remit of Member States.

Incidentally, these policies are the most sensitive politically, while the policies that were perceived as more bureaucratic and technical in nature – monetary policy, standard-setting in the internal market, competition policy or financial legislation – were subsequently transferred to the European level. This initial allocation of tasks was also viewed by many as a way of protecting historically evolved and deeply embedded national, social and economic models and preferences.

The crisis has shown, however, that this divide was all but artificial, that it did not address the spillover effects created by monetary union and, indeed, that it was not able to shield social contracts at the national level. In fact, it made things worse: the crisis showed that sovereignty over economic policies cannot be exclusively national. Sooner or later, pursuing policies that are inconsistent with being part of a monetary union will end in failure. Like a boomerang, policy mistakes come back to haunt countries and their neighbours in a monetary union, because policies are interdependent, and because important adjustment tools are no longer to hand.

In our case, the boomerang took the form of bubbles bursting and loss of market access, followed by harsh macroeconomic adjustment programmes. These programmes were necessary, and they worked. But they nevertheless came with economic, social and political price tags: economic and social, because implementing ad-hoc measures and the disorderly correction of imbalances always come at a greater cost than preventing imbalances in the first place. And political, because drastic corrections have consequences for political stability; they challenge the legitimacy of EMU.

Going forward, there is thus a clear choice: either we engage in a debate and end up collectively deciding how our economic and social policies can form a coherent European social contract that brings out the best in each national social contract and renders these sustainable,[3] or we continue to rely on the premise that the most essential economic and social policies are decided at the national level alone and wait for the boomerang to come back again. To my mind, this should not be a difficult call to make.

But making this call and moving forward without losing perspective will mean progressing beyond the functional narrative that has, in my view, reached its limits. It will require, once more, a clear political narrative to justify why drawing closer together is not only necessary, but is actually a good idea. In particular, such a narrative should demonstrate that, when we speak about more Europe, this does not mean that our cherished European social model is under attack; rather, more Europe is precisely what can protect and sustain the social achievements that set us apart from the rest of the world and that can help to further develop our social model to cope with the challenges of globalisation.

Conceptualising this kind of political narrative is, by definition, not the role of a technocrat; it is your job, not mine. But I would like to provide you with some reasons why I believe that a new

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3 See Coeuré, B., "Revisiting the European social contract", speech at the European Conference at Harvard, Europe 2.0 – Taking The Next Step, Cambridge, MA, 2 March 2013.

political and economic convergence process as proposed in the Five Presidents' Report[4] could lead you to such a narrative.

Towards a political and economic convergence process

A "convergence process 2.0"[5] should foster convergence, not towards nominal targets this time, but towards a similar level of resilience for economic structures.

"Resilience" is to be understood here both at the level of individual countries (i.e. internal adjustment mechanisms, such as price and wage flexibility to compensate for the loss of nominal exchange rates) and at the level of the euro area as a whole (i.e. cross-border adjustment mechanisms, such as risk pooling in capital markets or labour mobility).

Yet, in order to foster not only economic convergence and, moreover, go beyond this to create political convergence and lasting buy-in through a new political narrative, requires a process that is both economic and political.

What would be the key features of the economic dimension of the process?

In my view, a small number of simple, but important conditions would need to be met, namely a) consensus on designating economic policies as a shared competence; b) agreement on which policy areas should be subject to convergence; and c) a mechanism ensuring that convergence will continue beyond the end of the initial process.

If these conditions are fulfilled, a "convergence process 2.0" would not only be an effective instrument for preventing and managing imbalances and macroeconomic risks. In my view, it would also be a precondition for adding a layer of fiscal stabilisation at the European level. Sufficient convergence in terms of resilience could help Member States to deal with asymmetric shocks without leading to permanent transfers in one direction.

This is a necessity in a mature monetary union. It protects monetary policy from bearing a disproportionate share of the economic stabilisation burden. It also avoids what I have referred to elsewhere as "structural dominance" over fiscal policy, which amounts to fiscal policies being forced to do all the heavy lifting to stabilise the economy and, over time, to fiscal space becoming progressively exhausted. This overreliance on fiscal policy can in turn lead to dominance of fiscal policy over monetary policy.[6]

But we should not be fooled: common fiscal policies will be neither economically desirable nor politically feasible without a successful economic convergence process. Nor should we make the mistake of believing that they can replace the need to conduct sound fiscal policies at the national level. On the contrary, building trust and creating symmetry through conducting sound domestic policies and enhancing market-based adjustment capacities will be a necessary condition for moving forward.[7]

Indeed, this is why a forceful and thorough implementation of the current framework – the Fiscal Compact, Stability and Growth Pact, Macroeconomic Imbalance Procedure and Country Specific Recommendations – is indispensable for future progression.

But how should the conditions I have just outlined be translated into action? I believe that this is where we need to go beyond the functional narrative.

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4 Juncker, J.-C. et al, "Completing Europe's Economic and Monetary Union", June 2015.

5 See Coeuré, B., "Investing in Europe: towards a new convergence process", Athens, 9 July 2014.

6 See Coeuré, B., "Lamfalussy was right: independence and interdependence in a monetary union", speech at the Lamfalussy Lecture Conference organised by Magyar Nemzeti Bank in Budapest, 2 February 2015.

7 See Coeuré, B., " The future of Europe: building on our strengths", speech at the plenary session on "The Future of Europe" during the fifth German Economic Forum, Frankfurt am Main, 6 December 2013.

Why is this the case? As I stated at the beginning, there is a significant temptation to devise such a convergence process with a sole focus on output legitimacy: experts determine the relevant policy areas and the right policies, and a new strong independent institution enforces them afterwards. This would then lead to sound policy outcomes which would legitimise the process after the event. But this would bring us back to the functional narrative.

Indeed, a new convergence process cannot be a technical exercise for two reasons: first, the matters under discussion – be they labour market institutions, taxation, or the organisation of the judicial system and administrative capacity – are inherently political and much closer to the day-to-day life of citizens than, for example, monetary policy ever will be. Second, an institutional architecture in a democratic system cannot be based mainly on coercion. After all, in our everyday lives we do not follow rules because we constantly fear punishment, but because we believe in the purpose of the rules and understand that they can only work if adherence to them is the norm, not the exception.

We need a process that ensures the buy-in of citizens, governments and parliaments, that fosters a broad debate concerning our common understanding of what economic policies in a monetary union should look like, and that, for the most part, works based on consent to a common framework and provides fully legitimate institutions with the right instruments to intervene if the consensus is not respected.

This kind of political convergence process represents an opportunity: it could lead us to the political narrative I mentioned before.

But for that to emerge we would need to develop a common understanding of economic policies – it could mean that national parliaments and the European Parliament need to speak to each other more, as we are doing today.

If we were to commit to such a process, there would be a political cost to pay upfront as this would mean admitting to citizens that national parliaments alone cannot address all future challenges on their own anymore. But let us acknowledge that there is no such thing as a free lunch. This political cost is precisely the visible measure of collective commitment to the single currency project, which is necessary to ensure the economic and political resilience of EMU in the future.

European political parties could be a catalyst for such a debate – by organising more discussions than they do now, not along national lines, but according to social preferences. This could also mean that social partners would need to go beyond their national remit and adopt a European perspective.

Conclusion

The outcome of this kind of process would certainly not be optimal from a purely economic standpoint. That is a key feature of democracy. But it would be legitimate; it would not have to rely on its outcome alone to be acceptable, and it would give citizens a clear indication as to why we must move forward together. In my view, this would be a major achievement that would provide the political underpinning for EMU. It would not only create a more stable environment for growth and prosperity; it would also allow us, as a central bank, to conduct our monetary policy in an environment of much greater certainty. In the end, the more developed the “E” in EMU, the better we can do our job on the “M” side.

What I have proposed today is an opportunity for politics to reconnect with what matters most to our citizens; and an opportunity for Europe to move forward in the Weberian sense, with both passion and perspective, preserving what we have in common while accommodating differences where these are an asset. This would indeed be faithful to the model of the European Union – united in diversity.

Thank you very much for listening.