

Benoît Cœuré: Interview in L'Obs

Interview with Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, in L'Obs, conducted by Ms Sophie Fay and Mr Pascal Riché on 15 May, and published on 23 May 2017.

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In the United States, the administration wants to reconsider the banking regulations put in place after the 2008 financial crisis. The United Kingdom is tempted to do the same in the context of Brexit. In France, Emmanuel Macron also thinks that the steps taken were excessive. Is this a threat to the stability of the financial system?

Yes, the threat of deregulation exists. In many places there appears to be a temptation to revisit the financial regulation adopted by the G20 countries, which has been a huge project: we have strengthened the capital requirements and liquidity of banks, limited their size, regulated potentially dangerous products, such as derivatives, and started to put in order what's known as shadow banking, which takes place outside the banking sector.

It comes as no surprise that the financial industry dislikes these new rules. The large banks say that they hinder lending and increase the cost of capital. But this is not the case in the euro area, and even less so in France. Banks have significantly strengthened their capital base since 2010 and yet they have never made so many loans at such low rates.

The temptation of a regulatory race to the bottom exists in any industry, but it is even stronger in finance. It took enormous political energy on the part of the Heads of State or Government, following the financial crisis, not to give in to it. But whenever this political will weakens, the temptation of a race to the bottom returns. Such a temptation exists in the United States, although for the time being the new administration has not expressed any desire to backtrack on financial cooperation, either in the G7 or the G20, which is comforting.

Emmanuel Macron has also said that he wants to reconsider certain banking rules, notably on the required level of own funds.

His comment was born of good intentions: to facilitate the financing of SMEs. But there are other instruments available for that purpose. It would be useful if, once a year, the ministers of finance and economic affairs of the EU were to examine the impact of regulation on the financing of businesses. But that must not be a pretext for dismantling what has been achieved at international level.

Don't technocrats have too much power now in relation to these issues?

The agreements reached in the Basel Committee, which brings together central banks and supervisory authorities, have to be transposed into national law. As such, they are not binding. Politicians can always take back control. They are the ones who draw up and adopt the banking regulations. Should international technocratic fora be more transparent? Yes, probably. Mario Draghi has agreed to keep the European Parliament better informed about ongoing discussions.

What needs to be done in order to limit the porous boundaries between the banking sector and the world of politics?

In Europe, the answer is simple: the banking union should be taken seriously. The essence of the project is to "denationalise" supervision of large banks by entrusting it to the ECB, in order to harmonise supervisory methods and create distance between the supervisor and the supervised entity. Before the banking union, regulation and supervision of banks in each country was a kind of ecosystem, a co-production between the banks, the government and the banking supervisor.

And we saw the results: some banks took excessive risks in the markets, while others, which were no longer viable, continued without sufficient supervision to finance projects which no longer made economic sense. Taxpayers had to clean up the mess. The banking union reduces the sociological proximity between banks and the administrative and political powers.

As regards “sociological proximity”, the new French President is a former banker. Will the ECB will be more vigilant with regard to him?

One should avoid accusations. Georges Pompidou and Henri Emmanuelli also worked for Rothschild! The French political authorities were in the vanguard of the banking union: it is an achievement and it was not self-evident in France. What matters today is continuing in that direction.

Is financial deregulation a factor in the rise of inequality, as some are saying?

Financial regulation has its rightful place within a framework for combating inequality. As the economists Philippe Aghion and Angus Deaton have said, combating inequality involves combating rent-seeking. And yet the big forces of change today, globalisation and technological progress, create rents. Tackling these is not easy, because there are “good” and “bad” rents. If we want innovation to flourish, rent-seeking has to be accepted, at least temporarily.

Rent-seeking that obtains patents, for instance...

Yes. In order to encourage people to innovate they need to be able to enjoy the fruits of their innovation. But if rents are excessive, a minority appropriates the benefits of globalisation and technological progress. Finance is necessary to fund innovation, but it may itself become an excessive source of rent-seeking.

How?

Large financial institutions naturally tend to grow in size in order to exploit economies of scale, diversify, and reduce their financing costs. If they are too large, that creates a problem of competition and this creates rents. It also encourages a phenomenon specific to finance: being “too big to fail”. A large financial institution may take unreasonable risks because it knows that the public authorities will have no choice but to rescue it if something goes wrong... That race for size must be avoided by way of regulation.

Another phenomenon specific to finance is rents being built up by individuals. A proportion of financial industry employees are remunerated at unreasonable levels when measured against their value to society, as Thomas Philippon and Ariell Reshef have clearly shown. This misappropriation is socially unjust and must be regulated. Hence the EU legislation aimed at regulating the distribution of bonuses. Some countries, such as the United Kingdom, have gone further in making senior bank managers criminally liable in the event of excessive risk-taking or lack of control. It is a political choice. France also could do it.

All these rules reduce the risk of financial crises, which tend to deepen inequality. Too often in the past, taxpayers have borne the cost of bank recapitalisation post-crisis. And banking crises, by causing economic activity and employment to fall, hit the most vulnerable in our societies the hardest. Europe is endeavouring, with a set of new rules, to avoid the costs of these crises being borne by taxpayers, by calling on bank shareholders and creditors.

What is Europe doing otherwise to combat inequality?

To reduce inequality, redistribution instruments are needed, i.e. taxes and transfers. Only a legitimate, elected parliament can decide to tax some people to give to others. At global level, such a legislature obviously does not exist. At European level, it does. This is an extraordinary

opportunity! It should be used effectively.

The paradox of globalisation is that the greater the need for redistribution instruments, the more they are called into question. For example, it is becoming increasingly difficult to tax large companies, which are now operating on a global scale. The European Commission's action in relation to Apple in Ireland is a good example of what needs to be done to regain control of globalisation. And its plan to harmonise the corporate tax base is a move in the same direction.

The planets finally seem to be aligned in a way that permits the functioning of the euro area to be reformed. What do you think?

A window of opportunity is opening. It must be seized. In electing Emmanuel Macron, the people of France have confirmed their attachment to the single currency. This gives the new president a strong mandate but also a responsibility to bring forward proposals to reform the euro area. For the ECB, this is good news.

In the first round, half of the votes went to candidates who were very critical of the euro...

This shows just how much the reform of the euro area is needed! The ECB is mindful of this every day, having to ensure the stability of a single currency with 19 different governments which are often pulling in different directions and labouring to manage and resolve crises. That lack of efficiency takes a toll on economic activity and employment.

The euro brought stability during the financial crisis. The ECB's monetary policy is supporting the economic recovery. The euro area has created around five million jobs since mid-2013. But there is still a major, existential problem of lack of trust in Europe and lack of trust between Europeans, as shown for example by cultural prejudices between the north and the south.

Is this only a problem of trust? Isn't there also a mechanical problem, a design defect, which makes the euro a cause of divergence, rather than convergence, between Germany and the other countries?

It is not because of the euro that the unemployment rate is currently 4% in Germany and 10% in France. It's because the economic policy responses before and after the outbreak of the crisis were very different in the two countries. Admittedly, at European level, there has sometimes been a lack of coordination; solidarity instruments need to be improved. But there has also been a lack of commitment to reform in some countries.

Is Germany ready to accept more instruments of "solidarity": a European budget, Eurobonds, etc.?

There is a German prejudice – that Germany pays for the rest of Europe. This is largely untrue. Germany contributes to the European rescue plans in accordance with its economic weight, as do France and Italy. There are symmetrical prejudices in France; for example, the idea that unemployment in France can be explained by the euro being undervalued for German industry and overvalued for French factories. In fact, if unemployment is higher in France it is because the labour market is performing less well. We must overcome these prejudices, which fuel populism. Everyone needs to do their bit.

This is something that Emmanuel Macron has understood very well. France is expected to make proposals about reforming the euro area. But to be credible, it must itself undertake the reforms necessary to bring the French unemployment rate closer to the best performers within the EU.