Lorenzo Bini Smaghi: EMU@10 – the first ten years of Economic and Monetary Union and future challenges

Introductory comments by Mr Lorenzo Bini Smaghi, Member of the Executive Board of the European Central Bank, at a Public Hearing on EMU@10: The first ten years of Economic and Monetary Union and future challenges, Brussels, 24 June 2008.

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Madam Chair, dear Members of the ECON Committee, it is a pleasure to be here today and to share with you my assessment of the challenges facing Economic and Monetary Union in the years to come.[1]

In order to do that, I believe that there are a series of clarifications to be made, starting with an assessment of the past ten years. In any balance sheet there are assets and liabilities. The last ten years are full of assets, in many respects. One is the euro, and the creation of an area of monetary stability. Very few believed ten years ago that this could be achieved. I would like to quote Alan Greenspan, who in his recent book stated "*We have in front of us a historically unique institution, an independent central bank with the exclusive mandate to maintain price stability in an economic area producing over a quarter of the world GDP. It's an extraordinary result. I can't stop my admiration for what my European colleagues have been able to achieve*".[2]

Let's consider the negatives. What are the liabilities of the last ten years?

Some will claim that growth has been unsatisfactory over the past ten years. But is this really true? Looking at the euro area as a whole, growth on average has been the same as in the decade preceding the euro. There have been no recessions, while there was one in each decade before. Cyclical variability has been reduced. Budget deficits have been substantially lower. Employment growth has been much faster in the last ten years and unemployment has reached a 25-year low. Overall, in terms of economic activity, the last decade might not have been particularly brilliant, at least in the eyes of some, but it has been at least as good as the previous one. Incidentally, this is not the case for the US, which saw weaker economic growth overall in the last decade compared with the previous 10 years, and even a recession.

Some will claim that growth has been geographically patchy, with certain countries performing better than others. Indeed, eight out of the first 12 euro area countries have enjoyed economic growth comparable with that of the US. A few, in particular the larger ones, have not performed so well compared with the previous decade. Germany and Italy, for instance. Portugal too. France has performed better since the introduction of the euro. I should add though that Germany has caught up over the last three years.

If economic growth differs across countries, with some doing particularly well and others not so well, where is the problem? Is it the fault of the euro? Is it the fault of EMU? Is it the fault of Europe?

Some will answer yes, although for totally different reasons. On the one hand, you have those who think that insufficient growth is the result of insufficient economic policy coordination at European level. The solution, they would go on saying, is to create further European procedures, further initiatives to improve the economic governance of EMU. On the other hand, you have those who believe that insufficient growth is due to the bureaucracy

[1] The opinions reflect only those of the author.

[2] Alan Greenspan, "The Age of Turbulence", Penguin 2007.

of Europe's institutions, which leads to excessive regulation. The solution is, in this case, to give power back to the Member States.

Both views – in my opinion – are wrong, but they add to the confusion surrounding Europe, EMU and the euro. Ireland's recent rejection of the Lisbon Treaty reflects the confusion that many citizens feel about Europe.

What is needed, first and foremost, is clarity on who does what and who is responsible for what in the European Union. Some things are pretty clear. For instance, who is in charge of the main instrument for achieving price stability in the euro area? It's the ECB. And who is mainly responsible for enhancing economic growth? Who has the main instruments to achieve this objective? By and large, it's the Member States which are responsible for most of the policies that affect economic growth, from education to product and labour market regulation, from taxation to research and technology, etc. If economic growth has been less satisfactory in some Member States than in others, the main reason lies in one of these policies. This is what the Lisbon process is all about: to facilitate comparisons between the economic performance of different countries, based on a few key indicators and objectives. The process should encourage the laggards to catch up with the better performers.

What has happened instead? The Lisbon agenda has been blamed for Europe's unsatisfactory growth. It's like blaming the thermometer when you've got the flu!

The real problem of the last ten years has been the lack of clarity on the level of policy responsibility between national and European decision-making. This has created confusion for the citizens of Europe. That, in fact, is the main challenge of the next decade.

Too frequently "Europe" has been blamed for decisions taken by the Member States. For example, only a few months after signing the Stability and Growth Pact, some declared it "stupid". Others blamed that same Pact for obliging them to adopt tough budgetary policies, rather than explaining that these policies were for the good of their countries and of future generations. People inevitably asked: if the Pact is stupid, why did we sign it? And if it is indeed stupid, why do we have policies that comply with it?

Too frequently the European Union has been asked to act on specific issues by the national authorities, but the latter have not given the EU the means and powers to do so. How many times have there been calls for a common energy policy by the very same authorities who were at the same time negotiating bilateral agreements with energy producers? Of course, there have been other cases of similarly inconsistent or even contradictory behaviour.

Too frequently the institutional set-up of the European Union has been criticised openly, and sometimes severely, by some national authorities or even other European institutions. How can the people of Europe grow to trust the EU if the decision-makers at various levels question each others' competencies? The obvious example for me in this context is the ECB, whose independence and mandate have been repeatedly – and pointlessly – called into question over the past ten years.

We can't take up the challenges of the next ten years if we don't build on the assets achieved over the past ten years.

Calling for more cooperation at European level, for more procedures, more initiatives threatens to compound the confusion that already exists in the minds of both ordinary people and policy-makers. For instance, in its EMU@10 Communication, the Commission proposes that the Eurogroup should strengthen its monitoring of the implementation of structural reforms. Closer monitoring may help shore up a commitment to reform, but there is a real risk of further blurring the delineation of responsibilities.

I do not want to suggest that everything is going fine as it is in the allocation of responsibilities and that only a clarification is needed. I just want to draw your attention to what I consider a major risk. Recent experience shows that opaqueness and lack of clarity undermine our fellow citizens' respect for and even their interest in the European "construction".

The European Union will face many challenges in the next few years. Globalisation will continue, with its ups and downs, as in the past, and increased pressure on the use of finite resources.

These challenges will require better policies, both at national and European level. But, as I just mentioned, we should make clear which decisions are taken at national level and which ones entail a transfer of responsibility or closer cooperation. Confusion should be avoided, as it is a recipe for failure.

There is one big, uncomfortable fact that Europe and its Member States have to face. As time goes by, their relative weight in the world economy will decrease. If recent trends continue, by 2020 the share held by the European economy will fall from around 23% to 18% of the world economy. Germany's economy, the largest in the EU, will fall from 4% to 3%. In the decade thereafter, China and possibly India could overtake the whole of the euro area.

To be sure, the influence of individual Member States on world affairs will diminish steadily. This is nothing new. The first President of the European Parliament, Paul-Henri Spaak, commented 50 years ago: *"Today, Europe consists solely of small countries. The only relevant distinction that remains is that some countries understand this, while others still refuse to acknowledge it".* This is even more true today but will become a dramatic reality in a few years.

The euro area, and more generally the EU countries, have to make a choice. Do they want to have a say in the governance of globalisation or do they want to opt out of it?

The answer is not obvious. I have the impression that some would like the EU to become something like a large-scale Switzerland, some kind of neutral bloc staying aside from major world problems.

Assuming that the EU, or the euro area, wants to be an active player on the global stage, is it then ready to accept the consequences, particularly in terms of internal governance? Again, the answer does not seem to be obvious to many. If the Member States still want to have a say in world economic matters, but cannot achieve this through national representation, simply because as nations they are becoming less relevant, will they accept a pooling of their representation, at euro area or EU level? Or do they prefer to maintain their national seats around increasingly irrelevant tables?

These are not easy questions to answer, nor easy decisions to take politically. In a system where national prestige has still a political meaning, in the sense that it brings votes, and that political accountability in Europe remains based mainly at national level, it's not easy to transfer responsibility to a higher level of government. This is a dilemma that Europe, and its Member States, have to face, whether they like it or not. But it's better to have this debate out in the open than to fudge it by creating hollow structures.

The problem for the EU is that its citizens do not see it as helping to solve their everyday problems. The way to address this challenge is not to choose the middle ground, which would ultimately penalise the European "construction". Either it must be understood and clearly stated that certain policies and instruments are better performed at European level and the corresponding competencies transferred to that level, as has been the case with monetary and competition policies. Or those policies and instruments should remain unequivocally in the hands of national governments, and the inevitable process of coordination, even if strengthened, should not overshadow that level of responsibility.

Looking ahead to the next ten years, it's better to ask some hard questions than to paper over the cracks and sow confusion. There are several areas where these questions need to be asked, especially in respect of international financial institutions and policies, and banking supervision. The time might not be ripe for making substantive changes in some of these areas. However, it will have to be made clear why certain solutions are not followed. This is what accountability is all about.

Let me provide an example: people are facing a variety of problems resulting from the rise in commodity prices, in particular a decline in their purchasing power. One solution – in my view, the only solution for commodity importers – is to increase productivity in the goods and services sector. There are substantial margins for improvement in the services sector, especially if one compares Europe's economy with that of the US. How can we achieve these improvements? Each country can look after itself and adopt specific measures, as long as they are compatible with the single market. The EU, with the consensus of its Member States, can launch its own initiative to increase competition in the services sector throughout the EU. This solution might be more efficient, but it has partly failed in the past as some Member States opposed it. Can it be revitalised in light of more recent developments? A choice has to be made, and it should be clear.

Ladies and gentlemen, let me conclude.

Economic and Monetary Union has recently celebrated its tenth anniversary. As a ten-year-old, EMU is becoming less of a child and more of an adolescent. The trials of childhood were manifold: the creation of a credible central bank, the design of an effective and transparent monetary strategy, the distribution of new banknotes and coins, and the shaping of sound economic policies. Getting any of these basics wrong would have had catastrophic consequences. Yet EMU has successfully overcome the challenges of its childhood, while withstanding the many external shocks of the last decade.

The trials of adolescence are lurking ahead and will prove equally demanding. The continued success of EMU will depend on how effectively these new challenges are addressed.

Thank you for your attention.