Lorenzo Bini Smaghi: Celebrating 50 years of Europe

Speech by Mr Lorenzo Bini Smaghi, Member of the Executive Board of the European Central Bank, at the Project Europe 2.0, Institute of International & European Affairs, Dublin, 25 September 2008.

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Ladies and gentlemen, it is a pleasure to be here today to celebrate Europe's 50th anniversary.

It's quite nice to see that in Ireland anniversaries are still a reason for celebration 18 months after the effective date, although I'm not sure – judging from some recent polls – that in this country late celebrations are particularly beneficial to Europe.

On the day after their 50th birthday most people tend to fall into a depression. To avoid it, they first have a medical check-up. Then they go on a diet and take up some new sport. I know what it's like. I did it myself in the last couple of years!

One of the things I feared most, for my own future, was to be affected by so-called "cognitive dissonance", a problem many people seem to develop as they grow older.[1] You start reminiscing about the "good old days" – but in reality they weren't so good. You tend to remember only the nice things from your past, and see it all through rose-tinted glasses. As for the rest, well, you forget or suppress it. This is where nostalgia comes in. People end up thinking that the past was much better than the present, and much more pleasant than the future will be. They'd like to return to the past, their past. They become afraid of change and turn increasingly pessimistic. It's a terrible way to grow older!

At 50, Europe might be affected by this same syndrome. It should come as no surprise, since about 36% of Europe's population is over 50, and the proportion is rising. Europeans seem to be nostalgic about an irretrievable past and increasingly afraid of the future. They tend to see developments over the years in a way quite different from the reality. One of the victims of this syndrome is the European Union. The ultimate victims, however, might be Europeans themselves.

I won't elaborate on the theory of cognitive dissonance, but I will provide some examples of its symptoms and the potential implications for our common future. I'll consider four symptoms. The first is amnesia; in other words, Europeans seem to have forgotten what the European Union is about (assuming they knew it in the first place). The second symptom, derived from amnesia, is lack of consistency, which induces to create a link between facts and events that occur at the same time but which in fact are unrelated. The third symptom is myopia, which gives people a distorted view of the world around them, and thus the impression that nothing changes over time. The fourth symptom is denial, in particular concerning people's own vitality.

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Let me start with the first symptom: amnesia. People tend to forget what the European Union is all about. It's not even clear they ever knew enough about it. This is a long-standing problem and has never really been tackled. The fact of the matter is that our citizens have little idea of what the EU is and how it functions. This lack of awareness can easily be exploited, and indeed has been exploited, to paint a distorted picture of the Union.

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[1] Loosely speaking, cognitive dissonance is the uncomfortable feeling or stress caused by holding two contradictory ideas at the same time. The theory of cognitive dissonance proposes that people have a drive to reduce this dissonance by modifying an existing belief, or rejecting one of the contradictory ideas. This can lead to confirmation bias and denial of discomforting evidence.

The picture that people have of the EU shows the Member States and the Union almost as opposing forces, rather than the former coming together to make up the latter. When the Union takes a decision, it somehow looks as if it was a third entity – "Brussels" – who took it, rather than representatives of the Member States. In fact, the main decision-making body in the EU is the Council, which comprises representatives of the Member States, elected at the national level. The same can be said about the Parliament, directly elected by the people. And also the Commission consists of persons appointed by the governments of the Member States.

When the Union takes a decision, it is in fact the Member States which take it, through procedures established by the Union involving factors such as voting modalities and specific majority thresholds. When the Union fails to take a decision, it is ultimately the Member States which fail to do so, either because they don't want to or because they don't gain majority support for a proposal.

The Union is often accused of excessive regulation and interference. Whose fault is it? It always seems to be the fault of Brussels' bureaucrats, but they are not those who decide on regulations. They, at most, make formal proposals. It's the governments and agencies of the Member States which ultimately are responsible for creating excessive regulation; they are the ones that add extra conditions to take into account national circumstances or create exemption or special regimes, which go beyond the requirements of EU directives when transposing them into national law.

The confusion is compounded when accusations of overregulation come from those who attended the Council meeting that led to a particular decision, sometimes just afterwards. Voting in favour of a measure in Brussels and then criticising that same decision once back home is a favourite sport. No surprise that European citizens are confused.

The Union is also often accused of immobility, of not being able to decide. But if the Union doesn't decide it is because the Member States don't decide, or more often, because the Member States don't want the Union to take decisions. I will come back to this issue later.

The other misrepresentation is about the competences of the Union. They are much more limited than people generally think, but they are often at the heart of the misunderstandings and frustration that the Union creates. Let me be more concrete here, and give you some examples. I understand that one of the reasons for some people voting against the Lisbon Treaty in this country was the fear that Brussels, i.e. the other Member States, would decide on taxation in Ireland. It should have been clear that decisions on taxation cannot be taken without the unanimous consent of all the Member States. These fears, and similar ones about transfers of specific powers, were thus unjustified.

Overall, the range of the Union's competences is quite restricted. In the economic sphere, for instance, with the exception of monetary policy, its competencies are limited to the coordination of the Member States' policies. Again, one of the issues raised in Ireland by the opponents of the Lisbon Treaty seems to have been the EU's inability to deal with the economic problems facing ordinary people, in particular income and employment. The motto would be: *"Europe is doing nothing to help us out!*". But protecting people's income and livelihoods is a competence of the Member States, not the Union. While it is certainly an objective of the Union to achieve high living standards and high employment, as the Treaty says, the instruments to achieve these objectives are in the hands of the Member States.

People should know more about the competences which have been transferred to the Union, like monetary policy which is conducted by the European Central Bank, and those that have remained in the hands of the Member States. The confusion, which is at times exacerbated by the Member States themselves, penalises the Union, which is perceived as being over-powerful.

One example is in the energy sector. In the face of the recent increase in energy prices and the overdependence of European countries on a limited number of suppliers, numerous calls have been made from all the corners of Europe in favour of a European energy policy. But nothing has happened. When it came to taking decisions, the Member States showed no desire to hand over their powers in this field. The lack of a European energy policy is nevertheless seen as a failure of the Union, rather than of the Member States.

Europe is a complex construction, indeed. Its treaties, which are drafted as international legal documents rather than simple constitutional principles, are difficult to read. This is inevitable and we should not pretend that citizens can easily understand them, when even some politicians cannot. However, what is more difficult to accept is that, after 50 years, some of the basic principles of how the Union functions and what its competences are remain poorly understood by our fellow citizens.

Whose task is it to explain the basic facts about Europe? Should it be the role of European's institutions, such as the Commission? The Commission has small representative offices in each country, and most of the time they are busy trying to correct inaccuracies thrown in the national debates. The task of informing citizens about Europe can only be effectively undertaken by the Member States, which have well-established educational programmes.

The results – unfortunately – speak for themselves. And this is not without consequences, also for the politicians of the Member States. If the people of Europe don't understand the Union properly, they won't necessarily understand their domestic political situation any better. Indeed, polls show that even when the trust in European institutions declines, it remains in most cases well above the national ones. In fact, some of the negative opinions expressed on the Union, including in electoral consultations, tend to reflect negative views about national politics. This is the worst of all worlds for the Union: being blamed for something it's not responsible for.

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Let me turn to the second symptom, which derives from the first one, i.e. inconsistency.

Over the last ten years the world economy has undergone substantial changes. I won't list them all, but, to be sure, there has been a massive transfer of resources between and within countries. The change in the terms of trade has led to a huge transfer of purchasing power from advanced economies to oil and commodity exporters while globalisation has brought considerable benefits to low-cost exporters of manufactured goods. Just to give an estimate, the transfer of purchasing power due to the increase in oil prices alone amounts to around 3 trillion US dollars over the last decade, about 7% of advanced economies' GDP.[2]

The period between 2002 and 2007 saw the world economy grow at its fastest rate since the 1970s. However, this has masked notable differences between advanced and emerging economies. For the developing world, growth has been at its strongest since the Second World War. Advanced economies, on the other hand, have recorded a worsened performance. For the United States, in particular, the last decade has been the worst, in terms of per capita income growth, for over 100 years, with the sole exception of the 1930s. Growth in Europe has also been quite modest compared with previous decades.

A significant redistribution of income has also taken place within countries. In some advanced economies, notably the United States and the United Kingdom, the index of income inequality has risen.[3] In general there has been a stagnation or even a tendency towards a reduction in purchasing power for the lower-income groups, as a result of weaker income growth and higher price increases for products such as food and energy. Income

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2 Based on the amount of net oil imports by advanced countries, comparing a scenario with oil prices unchanged at 1999 levels with actual data. I thank Michael Fidora for this back-of-the-envelope calculation.

3 For an extensive treatment see A. Brandolini and Smeeding (2007): "Inequality: international evidence", prepared for the New Palgrave Dictionary of Economics.

growth disparities reflect increasing differences in human capital, access to technology and educational levels. Theory and past experience both suggest that competition from low-cost countries tends to penalise low incomes and employment advanced economies' sectors with lower technological content.

The acceleration of technological change and the dismantling of barriers to trade have increased international competition and brought about adjustment in a much shorter time than expected. Advanced economies have thus felt severe strains in the last decade, and we can observe the political and social implications on a daily basis. The current US electoral campaign confirms that the issues are similar on both sides of the Atlantic.

With one difference. In Europe, the last ten years have also been marked by the birth of the euro. And this is where the lack of consistency arises. The euro was created to bring about monetary stability in Europe. And this goal has been achieved. Inflation is low. Interest rates are low, reflecting low inflation expectations. The European Central Bank has acquired credibility by conducting a monetary policy aimed primarily at price stability. The euro has become the second international currency, trusted by investors all over the world.

The recent market turmoil should encourage us to think about what could have happened without the euro, in terms of speculative pressures within Europe, exchange rate variability and interest rate levels. We would certainly have been worse off.

Most Europeans tend to forget about the advantages they have acquired over the years, even those been gained only recently. Being a member of the European Union and the euro area isn't considered a big deal. On the other hand, many of the problems of everyday life are blamed on Europe or the euro.

The euro is sometimes considered responsible for problems that have affected our economies in the last few years, such as the increase in housing prices, higher food and petrol prices, especially at the time of the cash changeover, and relatively subdued growth. As I have just mentioned, these problems have been experienced not only in the euro area but in all advanced economies, including those that don't have the euro. I would contend that some of the problems, such as inflation and income inequality, have been even greater outside the euro area. It is nevertheless difficult to explain to citizens that events taking place at the same time in a country are unrelated. The euro is an easy scapegoat. Attributing the fault to the euro is an easy way for individuals and governments to avoid taking responsibility.

The confusion as to who's responsible for what in the Union and the simultaneous occurrence of the euro's creation and other events that took place in our countries in the last decade have led many people to be inconsistent in their assessment of what the euro – and Europe more generally – has achieved in all these years.

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Let me turn now to the third symptom, myopia. The difficulty to fully understand the causal relationship between events affecting our societies and our own lives derives in part from a form of short-sightedness concerning the world around us. As we grow older we tend to think that the world is the same as it always was. Maybe it's a natural reaction to growing older. But in fact the world around us is changing, in a way that affects our lives and our ability to act.

Europeans in particular have a tendency to think that the world hasn't changed much over the last 10 to 20 years. More worryingly, they tend to believe that things won't change much in the future. In reality, change has been all around us and will accelerate further in many areas. I won't dwell on this issue, but the bottom line is that Europe is getting smaller and smaller, while other continents and economies are growing. 20 years ago the EU represented 28% of world GDP. In 2020, if recent trends continue, the figure could be less than 18%.

Individual countries within Europe are also becoming smaller and less powerful. There is nothing new in this. 50 years ago, the first President of the European Parliament, Paul-Henri Spaak, noted that "*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".*

20 years ago France and Germany together represented close to 10% of world GDP. Today this percentage is 7.5%. By 2020, if recent trends continue, it will be reduced to 5%, less than Germany alone 20 years ago.

Other regions and countries are emerging as major players, their size comparable to that of the whole European Union. Individual European countries are bound to have each a lesser role to play on the global arena. This is already the case in trade, international finance, the environment, energy.

How long will it take for European countries to realise that, in terms of power, they have become close to irrelevant? Paul-Henri Spaak's words might lead one to think that this myopia affects only the larger countries of Europe. This might be true. But smaller countries can suffer from another type of short-sightedness. Smaller countries are used to having a more limited role on the international scene. They tend to leave major decisions to the larger countries, acting more as critical observers. They can afford to do so. Indeed, the post-Second World War world has developed in an environment largely dominated by the United States, with the cooperation of European countries. The US influence shaped relations in the field of international finance, world trade and macroeconomic policy. The rules and policies pushed forward by the United States, and its leadership in implementing them, were broadly accepted by Europeans. Even in the military field, the confrontation with the East took place under the protection of the US umbrella, even for countries that declared themselves neutral.

In the coming years it will become more difficult for a single country alone, even the United States, to set standards and lead policies for the rest of the world. The emergence of other regions and countries with larger populations and soon similar income to that of the United States will challenge its leadership. International relations will have to be based increasingly on cooperation between equals rather than the leadership of one country, as they have been for the last 60 years. China, India and possibly also Brazil and Russia will play a greater role in global decisions.

The key question in this scenario is: what will Europe, and European countries individually, do?

They can ignore these developments and continue to act as followers of a leadership which will have become more varied, accepting the balance of interests that will have been agreed between the United States and the other systemically important countries. They can continue to free-ride, but the outcome might be quite different and not quite as pleasant as it has been up to now. Alternatively, they can organise themselves and form a major player in the international community, possibly in partnership with the United States. All European countries, not only the largest ones, will have to make this choice. To make Europe a key player will require the will of all its members.

My impression is that European citizens would be less frightened of the challenges of globalisation if they felt they could participate in its governance. The problem is that globalisation can't be controlled at the level of national governments, at least in Europe. Europeans can participate in the governance of globalisation only if they stand united.

Let me give you an example. The current financial market turmoil will have to lead to new financial regulation and supervision. In an increasingly integrated financial market, the new regulation and supervision will have to be the result of coordinated action on the part of major economies. This will involve accounting rules, prudential regimes, the treatment of offshore centres and hedge funds, etc. The new rules will have to be discussed and agreed across the Atlantic. The experience of the past few months suggests that the European contribution can be particularly useful in designing a more stable and prudent financial system. To promote its views Europe has to organise itself to speak with one voice at the negotiating table. If Europeans are divided, unable to take decisions, they will have to accept what's decided elsewhere.

Ultimately, speaking with one voice and taking decisions means deciding by (qualified) majority. It means that each member accepts being put in a minority by the others, as in a democracy. It means, ultimately, increased political integration in Europe. In other words, either European countries move towards increased political integration or they become irrelevant on major issues that are of relevance on the international scene. It may sound a bit blunt, but at least it's spelt clearly!

One objection to the choice of greater political integration is that some fundamental competences are inherent to nation states and cannot be given up without impairing the political integrity of those states.

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This brings me to the fourth, and for now final, symptom which seems to be affecting some Europeans, i.e. denial. As people grow older, the performance of certain functions – especially the more pleasant ones, which in some cases reflect power and potency – tends to be impaired. Science may to some extent help us to delay the slow but inevitable decay. On the other hand, it can also lead us into a dangerous state of denial.

The same seems to apply to political power. As Europe and European countries grow older, and also smaller, they continue to deny the fact that their effective power is shrinking, if not disappearing. For instance, many fora in which several European countries participate have lost relevance. And one of the reasons for this is that Europeans are over-represented in these fora, which reduces their legitimacy.

Let me give you the example of the International Monetary Fund where EU countries are represented in ten different constituencies, out of 24. The euro area countries are spread over eight constituencies. Some are even in constituencies in which all other countries are non-European; Ireland, for example, is in the same constituency as Canada and Caribbean countries.

Given the way Europeans are organised, it's no wonder the IMF is largely influenced by the United States and that Europeans tend to punch much below their weight. Furthermore, major decisions concerning the IMF are increasingly taken in other fora, typically the G7 or the G20, where only the four largest European countries are represented. The EU is also a member of the G20, but given the rotating EU presidency, it isn't able to have a substantial impact on the discussion.

The most logical thing to do would be to pool European representation in the IMF and thereby obtain a power of veto like that of the United States so as to play a greater role. This would of course require some organisation within Europe to define a common policy, as is done for trade issues for instance. As the IMF has become an institution focused primarily on surveillance of the world economy, I see no reason for European countries, especially those with a common currency, to have differing positions on the major issues discussed at the IMF. For example, I see no reason for a country such as Ireland to have positions more similar to those of Canada and the Caribbean countries than to those of other members of the EU.

If Europe had a single seat at the table, the national representatives that currently have a seat would have to leave it. And they seem to be very attached to their seats, because they believe – or want to believe – that from this position they have been able to substantially influence decisions. They often don't understand – or don't want to understand – that as long as they are seated at the table, while others who matter more are not, that table is not really worth sitting at. The main decisions will be taken elsewhere.

Again, to give an example, the recent reform of the voting shares of the IMF, which by the way reduced the overall voting power of Europe, wasn't really decided in the IMF Executive Board itself but agreed in other fora, most notably the G7 and the G20.

Those who would have to leave their seat at the table are obviously in a state of denial, advancing quite absurd arguments. The oddest of all arguments against a single European seat is that it would create a polarisation in the governance of the Fund, with two major shareholders – the US and Europe – which would undermine its functioning. As if a unipolar governance, with only one major shareholder (the United States), is better from the perspective of any European country.

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I have talked enough today about symptoms and syndromes. Let me conclude.

Like anyone over 50, Europe needs to make sure it doesn't become a hypochondriac. As I mentioned at the start of my speech, Europe might need to go on a diet. And maybe get a new look.

The diet consists in streamlining activities. The EU seems much fatter than it really is. European institutions should stop continuously looking for new roles. The celebration of the 10th anniversary of the euro ended with a series of recommendations, in particular from the Commission and the European Parliament, for new roles, but with no resources and no powers. This gives the impression that the EU will have new competences, which is not true. The Union should instead clarify its role and show how slim it is. It should actually refuse to take on new tasks that Member States want to give it unless it explicitly receives the powers to conduct these tasks.

At 50, Europe also needs a new look. Any book or film about Europe starts with a sequence of black and white pictures of the founding fathers. Most Europeans – unfortunately – don't even recognize the faces of Schuman, Monnet, De Gasperi or Adenauer. This shouldn't be surprising. They'd probably also fail to recognise the national politicians of those days.

History books are certainly useful, but pictures can be more effective than a thousand words. If I had to choose one picture to explain to current and future generations what Europe is about, I would take that of François Mitterrand and Helmut Kohl joining hands in Verdun, in September 1984. Some younger people might not recognise the two faces, but their act is unequivocal. Joining hands in front of a coffin explains everything about Europe, where we come from.

But that's clearly not enough. The people of Europe need a better understanding of what the European Union is about, what it has given them and where it is going. The Union should be seen not just as a grouping of states but as something helping the member states, and their citizens, to address the challenges of our times. The Union is not somewhere else – in Brussels or Strasbourg – it's in every European town or village, whose prosperity depends on being part of a united Europe.

The future of Europe depends on each of its 500 million citizens. But, more importantly, the future of the 500 million citizens depends on the future of the Union. The best way to celebrate this 50th anniversary is to make sure that the best years are still to come.

Looking back on what has been done should strengthen our will and our confidence about what we can achieve in the future, together.

Thank you for your attention.