Jean-Claude Trichet: The essence of economic and monetary union

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, as the Guest of Honour at the Schaffermahlzeit, Bremen, 11 February 2011.

* * *

Gentlemen,

I have given speeches in many different places over the years, but today's setting here in Bremen is a very special one.

Speaking at an event that has taken place every year since 1545 is a very great honour. We central bankers pride ourselves on thinking about the long term, but even for us, 466 years is a deeply humbling period of time.

I would like to thank you very, very warmly for inviting me to become part of this longstanding tradition in the nautical, commercial and political life of your city.

This dinner is unique, not just in Germany but across Europe. And as guests can be invited only once in a lifetime, we cherish every minute of this fortune. Let me therefore thank you on behalf of all of the guests here today.

* * *

The name "Freie Hansestadt Bremen" speaks volumes of this city's long history of proud independence. Yet the historic independence of Bremen has never meant isolation.

On the contrary, the greatness of this city lies in the Hanseatic League, an early example of the principles on which the European Union is founded – that commercial and cultural interchange builds common interests between peoples – and that such interchange raises the costs of conflict, facilitates compromise and fosters cooperation.

The Hanseatic cities symbolised the principle of "*doux commerce*" about which Montesquieu would later write: *"nations that traffic with each other become reciprocally dependent; and their union is founded on mutual necessities."*

Monetary matters were part of a thriving environment for commerce for centuries, and at times single currencies were established. For a long period in the 14th to 16th centuries, in the Wendischer Münzverein, the core cities of the Hanseatic League – Lübeck, Hamburg, Lüneburg, Wismar, Rostock, Stralsund – shared a common currency, the "Lübische Mark".

Today, a far wider group of great port cities shares a common currency. The ports of the old Hanse-cities Bremen, Hamburg, Lübeck, Rostock, Wismar and Tallinn all lie within the euro area – but so too do Helsinki, Rotterdam, Antwerp, Bordeaux, Cadiz, Porto, Marseilles, Genoa and Venice – to name but a few.

The European single market is a vast economy. The euro area itself is a truly continental economy. The population of 331 million exceeds slightly that of the United States, and in geographical terms Lisbon and Helsinki are almost as distant as Los Angeles and New York.

Interestingly, the European Union as a whole and, in particular, the euro area are significantly more open in terms of trade and finance.

In the year prior to the crisis, 34% of GDP of the euro area was imported or exported. In the United States, the ratio was 24% of GDP. The euro area is the world's largest exporter, accounting for 15% of world trade – 50% higher than the shares of each the United States and China.

Europe's openness is also remarkable in international finance. Last year, international financial assets and liabilities reached almost 170% of GDP, compared with 140% for the

United States and 80% for Japan. Inward and outward direct investment, at 47% and 39% of GDP, are larger than for the United States, where both are less than 30%. The euro area is indeed a remarkably open economy.

Speaking in Bremen, I would say that the euro area of today is a continuation of the best tradition of the Hanse: open to the world.

* * *

The maritime traditions of Bremen resonate deeply with me. Having family roots in Saint-Malo in my beloved region of Bretagne, I share your passion for sailing and the sea.

Indeed, I have often used a seafaring metaphor for Europe's monetary union, arguing that it is better to be on a large and steady ship rather than on a small vessel, particularly in the turbulent waters we have experienced in recent years.

As guardians of the single currency, we at the European Central Bank know that we have to stay on course. We have only one needle in our compass, which is price stability. We are presently observing an increase of prices largely reflecting higher energy prices. As I said on behalf of the Governing Council both in January and in early February, risks from the medium-term outlook for price developments are still broadly balanced but could move to the upside. This is the reason why we must remain permanently alert.

* * *

This evening I would like to speak to you about the achievements of our monetary union and about the challenges for the broader construction of EMU – Europe's economic and monetary union.

Having had the privilege of serving as ECB President for the past seven years, I can report that we have achieved a great deal, and all Europeans should take pride in these achievements. Yet several improvements need to be made to our economic union.

We need to ensure that monetary union is complemented by fiscal and macroeconomic policies that are focused on sound and stable principles and, therefore, foster sustainable growth.

We need to ensure that all governments have sound public finances.

And we need to ensure that the rules that govern EMU are sufficiently strong to ensure that all parties act in a way that serves our common interest.

All of this to achieve our common goal: a union of individual freedom and collective respect; a union of responsibility and cooperation; and a union of stability and prosperity.

1. Achievements of the euro

Let me begin with what we have achieved. The euro was introduced to manage economic and monetary interdependence between European countries; to reap the full benefits of their economic and political cooperation for the individual and collective good; and thereby to contribute to lasting peace and friendship among peoples. All of this, while preserving the diversity that makes Europe unique.

The specific construction of our modern economic and monetary union rests on two separate economic and monetary pillars. Under the monetary pillar, there is only Europe: the single currency, the single monetary policy, and the single central banking system – the Eurosystem, which consists of the ECB and the national central banks of the 17 members of the euro area.

The economic pillar is more decentralised, with responsibility for fiscal and economic policies in the hands of individual countries. These policies should be steered by overall rules and coordinated to ensure that national economic policies are fully compatible with the fact that we have a single currency without being part of a political federation.

When it is working properly, this structure balances the independence of nations and their economic interdependence that is at the heart of EMU. It should represent an approach where sovereignty is shared, meaning that it is neither exclusively national nor exclusively European.

When EMU was first established, many people asked how monetary union could function effectively in a Europe of sovereign states. The answer is that it can function effectively with an appropriate economic union.

Not necessarily an economic union with a single fiscal authority. Not necessarily an economic union that presupposes an achieved political federation. But an economic union in which national policies are set within agreed limits and are subject to rigorous and effective mutual surveillance.

If the question is asked how to improve the economic pillar, the answer is to have more stringent rules and stronger mechanisms to ensure compliance.

2. The "M" in EMU

Let me discuss the two pillars in a little more detail, first the M in EMU. In monetary policy terms, the ECB has a clear assignment: to deliver price stability.

According to our primary mandate, our definition of price stability means an inflation rate below but close to 2% over the medium term. This is the needle in our compass. Our medium-term orientation means, figuratively speaking, that we provide the steady hand on the tiller.

How can the citizens of the euro area have confidence in the steady course of monetary policy? They need only look at some facts.

Over the 12 years since the launch of EMU, the average annual inflation rate in the euro area has been 1.97%. This is the best result of a major central bank in the euro area over the last 50 years.

For Germany, the inflation rate has been even lower than the average since the euro was launched. From 1999 to 2010, inflation averaged 1.5% per year. By comparison, the average inflation rate in Germany in the 1990s, prior to the introduction of the euro, was 2.2% per year. In the 1980s, it was 2.8%. In the 1970s, it was 4.9%.

The ECB has sailed this steady course in what has often been stormy weather. We are currently focused on the crisis, but even before 2008 we did not always experience calm waters.

In 1999, we began with a completely new institution – the ECB – and a cooperation among central banks as one unified system. Over the years, we have had to cope with the bursting of the internet bubble, the aftermath of the events of 11 September 2001, the jump in oil prices to $145 per barrel, rising prices of food and commodities, and then of course the worst financial crisis since the Great Depression.

Yet throughout these very different economic shocks – which could have been either inflationary or deflationary – citizens in the euro area have remained confident in our steering. Proof of this is that medium- to long-term inflation expectations have been firmly anchored in line with the ECB's definition of price stability.

Observers and financial markets are also expecting in the years to come that price stability will be maintained, and inflation will remain low. For this year and next, inflation rates are expected to be just below 2%, and for the next five years, professional forecasters currently foresee inflation of precisely 2%.

As you can see from these figures, it is clear that monetary policy in EMU has fulfilled its role of delivering price stability and will continue to do so.

3. The "E" in EMU

Let me turn to the economic pillar, the E of EMU.

Here, we need fundamental reforms.

Economic union is a fundamental counterpart to monetary union.

A single market with a single currency calls for a very solid framework for handling the collegial governance of national fiscal policies and macroeconomic policies.

This is something recognised by the citizens of Europe, particularly those in the euro area. Surveys indicate that, on average in euro area countries, more than four out of five euro area citizens are in favour of greater policy coordination between countries to overcome the crisis. This is something very important: Citizens want a stronger coordination of economic and financial policies among the countries of the euro area.[1]

European integration has led the people of Europe to reappraise the value of cooperation in difficult times. The euro area countries are in the *avant garde* of this process. Being together in a single ship – in an ever closer union – is what holds Europe together through stormy weather.

Already Jean Monnet recognised, back in 1950, that it is the necessities of interdependence, which become more evident in times of crisis: "L'Europe ne se fera pas d'un coup, ni dans une construction d'ensemble: elle se fera par des réalisations concrètes, créant d'abord une solidarité de fait."

What does more coordination require? It means making two vital sets of changes – strengthening economic governance and enhancing the opportunities for sustainable growth. Let me address these changes in turn.

a. Need to strengthen economic governance

The first change that is required is what I have called a true "quantum leap" in the rules that regulate how countries make their national economic policies. Countries need clear rules and procedures to guide policy-making and sanctions if they stray from a sustainable path.

This means strengthening the Stability and Growth Pact, the framework first negotiated by the German finance minister Theo Waigel to prevent countries accumulating excessive public debts and deficits.

Equally importantly, it means putting in place a new framework for overseeing economic policies more broadly – such as competitiveness, current account balances and levels of private borrowing – to prevent problems emerging in the private sector.

Let me lay out for you why strengthening the Pact is so important.

The period between 1999 and 2008 was generally acknowledged as a period of economic fair weather. Yet in this period, hardly any euro area country put their fiscal house in order, attaining what might be called a safe budgetary position.

What is more, governments decided to *weaken* the Pact in 2004 and 2005. This initiative was led by the euro area's largest economies. The ECB voiced its "grave concerns" at the time. I

---

[1] Economic Governance in the EU, Standard Eurobarometer survey 74 (published 12 January 2011).

now see that many acknowledge that the weakening of the Pact was a serious misjudgement.

But the crisis has given us an opportunity. It has made plain the flaws in the Pact that allowed countries' fiscal policies to become a problem, not just for themselves, but for everyone else within the monetary union. We now have an obligation to fix the flaws.

First and foremost, this means creating stronger and more binding rules for fiscal policy, backed up by reinforced sanctions or mechanisms to ensure compliance with the rules.

Second, a new framework is needed to monitor competitiveness and to ensure that measures are taken to control them. We need to put in place binding rules that guide policies towards sustainable and balanced growth.

Such a reform package is currently before the European Parliament. The ECB very much counts on the Parliament to call for very clear and strong governance rules, including automaticity in triggering procedures and sanctions, which will be to the long-term benefit of Europe's citizens.

In a union with a single monetary policy and 17 different fiscal and economic policies, a "quantum leap" in economic governance is necessary to ensure that the degree of economic union is fully commensurate to the already achieved monetary union.

b. Need to enhance growth potential

The second change that is required to the economic pillar of EMU relates to Europe's potential for growth.

Europe has fared reasonably well in the past decade. Adjusted for differences in population growth, per capita GDP growth in the euro area has been almost the same as in the United States, at about 1% per year. The euro area has also made significant progress on employment, which has grown by over 14 million, compared with a rise of 7.8 million in the United States.

This is encouraging, but it remains insufficient. We cannot be complacent in any respect. Europe must develop its growth potential continuously. All countries must pursue resolutely their structural reforms, in pension systems, product market and labour markets. Jointly, they have devised the Europe 2020 strategy. Education, research and innovation is one key area; resource efficiency a second; and high employment and social cohesion the third main area.

The European Central Bank fully supports all efforts along this Europe 2020 strategy. A specific example is the completion of the Single Market in services. It makes full economic sense that the internal market in services, which is the sector in which the majority of people work, is fully completed. New areas of growth, like the digital sector, energy and the environment will clearly benefit from more competition and create new jobs.

4. Conclusion

Let me draw to a conclusion. We are today 12 years into economic and monetary union. I have emphasised our achievements and I have emphasised where we need to strengthen the framework.

Monetary union can function effectively in a Europe of sovereign states with an appropriate economic union. And creating an appropriate economic union is where the reform efforts need to be directed.

For that, we have to do in Europe what Alexis de Tocqueville so admired in 19th century America, whose greatness did not lie "in being more enlightened than any other nation, but rather in the ability to repair her faults."

When repairing the faults in our governance framework, we must not let the indications of economic recovery distract ourselves from the urgency for action. Policy-makers must keep in mind that the governance failures of the past are still to be fixed and the growth challenges of the future still to be solved.

While I have stressed the challenges we face, we must also recognise our achievements.

Europe is in the vanguard of nations working together peacefully.

We have replaced confrontation and conflict with cooperation and consensus.

We have combined political freedom with economic freedom and social peace. These are remarkable achievements – and they are quite clearly achievements to which many people elsewhere in the world are aspiring.

It is for this reason that I have dedicated all my working life to put the French-German friendship to the service of Europe as a whole, with all nations united. And it is for this reason that I believe deeply in our economic and monetary union.

The Europe to which I have dedicated my career is one where different countries, different regions and different cities retain what Victor Hugo called their "distinct qualities or glorious individualities".

It is also a Europe whose cities, regions and countries realise that, through working together, they can be greater still.

Thank you for your attention.