Benoît Cœuré: Restoring confidence in the euro area

Remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Festival dell'Economia, Trento, 1 June 2012.

* * *

Ladies and gentlemen,

I would like to thank Tito Boeri and Lucrezia Reichlin for their invitation to this sharing of views on how to restore growth in the euro area.

Central banks are not central to delivering long-term economic growth. Long-term growth is about education, innovation and the functioning of markets, none of which is really in our hands. We can nevertheless contribute by providing stability – in particular, price stability, which is at the heart of our mandate, as well as confidence.

Let's face it: the euro area today lacks both stability and confidence. Price stability has been achieved and the ECB will strive to maintain it, but financial markets are under strains. The question being asked today by market participants no longer concerns a particular country or sector: it is whether the political commitment exists to support the euro as a project and to improve this project. The answer to this question should be clear: the euro has brought immense economic benefits to its member countries, both in northern and southern Europe, and to non-participating countries such as the UK. We must unite to support the euro as a project and to decisively improve it.

What does it take to restore confidence?

First, governments should pursue their efforts to bring down public debt. They have exhausted their fiscal room for manoeuvre and must rebuild it so as to be resistant to future shocks. Fiscal consolidation weighs down on short-term economic activity, but it is a precondition to crowd in private investment and restore long-term growth.

Second, we must put a halt to financial market fragmentation. The disintegration of euro area capital markets has reached a point where it puts at risk the whole European project, including the single market for goods and services. European firms can no longer finance their investments from a single pool of savings. This hampers the possibility of a sustained and high level of growth. By extending ample amounts of liquidity to euro area banks, the ECB has mitigated the retreat of private cross-border capital flows. It is not its role however to allocate financial resources across the region. Resource allocation should be performed through market mechanisms, with appropriate price signals.

Bringing euro area capital markets together will require more than technical adjustments. There can indeed be technical considerations, such as the impact of the forthcoming liquidity regulation under the Basel III agreement, which should be calibrated in such a way that it does not impede the functioning of the interbank market. But it's trust that is the essence of the lending relationship. Restoring trust in banks and disentangling the fate of banks from that of governments are absolute prerequisites.

The ECB's two longer-term refinancing operations, or LTROs, have been powerful enough to ensure continued excess liquidity and to ease most of the tensions in funding markets. But there is nothing that the ECB can do when it comes to banks' solvency. Euro area banks should strengthen their capital and do it in a way that makes them less dependent on their governments. To this end, the euro area needs a single resolution mechanism and resolution fund, and a unified mechanism of deposit insurance. Banks that need recapitalisation must also be allowed to directly access the European Financial Stability Facility (EFSF) and, when it is in place, the European Stability Mechanism (ESM). Let me add a warning. Letting euro area banks access the EFSF/ESM should not be a way for governments to escape their responsibilities and to rid themselves of the cost of past errors. It should be accompanied by strong, centralised supervision of systemically important institutions.

In a nutshell, the only way out of this crisis is to map out a credible path towards a stronger Europe. Of course, far-reaching institutional changes can only be based on democratic deliberation, especially as some of those changes would entail an additional transfer of responsibilities to a supranational level. Any such mechanism should have strong democratic foundations and be subject to appropriate accountability, in particular to the European Parliament.

How then can growth be achieved?

Price stability and financial stability are essential preconditions for growth. What can then be done to improve the long-term rate of growth of the euro area?

Many good ideas have been floated here and I will not repeat them. A lot can be achieved in my view by strengthening the single market for goods and services. So far, the single market has not suffered from the ongoing crisis, but we all know that it has not been completed, especially in services. Mario Monti made some proposals in this respect in 2010, as did Michel Barnier more recently. Competition is of the essence. In many sectors, rents are appropriated by special interest groups and should be returned to the people of Europe. Finally, investment in research, human capital and infrastructure is key to ensuring that the negative impact of austerity remains limited in time and does not weigh down on the long-term growth potential. New ways of pooling resources and financing the common provision of public goods should be found.

I conclude on a positive note. Overall, the euro area has a high private saving rate and sound fiscal fundamentals, with deficit and debt ratios that are much lower than in the US, the UK or Japan. Its workforce is industrious and highly skilled; its firms are innovative and do not fear global competition. If the euro area unites and overcomes the present crisis of confidence, it will emerge as a strong economy for the rest of the 21st century.

I thank you for your attention.