

Mario Draghi: Introductory remarks at the French Assemblée Nationale

Speech by Mr Mario Draghi, President of the European Central Bank, at the French Assemblée Nationale, Paris, 26 June 2013.

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Presidents,

Honourable Members of Parliament,

I would like to thank you very warmly for having invited me to address this historic chamber.

As President of the European Central Bank, it is an honour to speak in a nation that has done so much to promote and further the cause of European integration.

It was exactly 300 years ago, in 1713, that the Abbé de Saint-Pierre presented his *Project for Perpetual Peace*, one of the first visions for a union between European nations.

That this vision emerged into reality is thanks in large part to generations of French thinkers and pioneers, like Jean-Jacques Rousseau, Victor Hugo, and Aristide Briand. It is also thanks to the makers of the modern European Union like Robert Schuman, Jean Monnet, and Jacques Delors.

In other words, this country has played a key role in building the peaceful, open and united Europe we see today.

But as you know, the EU, and the euro area in particular, is faced with important questions about its direction. It needs a new consensus on how to move forward.

I am confident that France will again play a key role in that process.

In my introductory remarks today, I would like to focus on three topics: the ECB's monetary policy, growth and adjustment in the euro area, and the progress towards building a deeper economic and monetary union.

I am here today to present the ECB's views, but also to listen and to learn. I look forward to hearing your opinions and taking your questions.

The ECB's monetary policy

Let me begin with the ECB's monetary policy.

The ECB's mandate is to maintain price stability, which is essential to support long-term growth, defend citizens' purchasing power and maintain sustainable and high employment. In order to deliver our mandate, the ECB has done a great deal to support the euro area economy.

First, we have reduced our main interest rate to the historic low of 0.5%.

Second, we have introduced a series of measures to ensure that banks can pass on these low interest rates to borrowers in the real economy.

These measures include allowing banks to borrow as much liquidity from the ECB as they need; expanding the range of collateral they can use to access that liquidity; intervening in bond markets that were malfunctioning, like the sovereign bond market or the covered bond market; and launching two three-year Long-Term Refinancing Operations (LTROs), which injected more than 1 trillion euro into the euro area banking system.

Overall, our balance sheet increased from just below 1.5 trillion euro before the crisis to more than 3 trillion euro at its peak.

Our measures are primarily focused on banks because, in the euro area, bank lending is the main channel through which firms and households get access to finance.

Around three quarters of firms' external financing comes from banks, compared with only around one quarter in the United States. Supporting the banking system is therefore essential to support growth in the euro area – and to fulfil our mandate to maintain price stability.

More recently, the ECB has acted to remove unfounded fears about the future integrity of our monetary union. These fears were creating severe turbulence in financial markets and preventing our low interest rates from reaching the countries where they were needed most.

As a result, we saw a risk of a widespread credit crunch in these countries. Questions over fiscal sustainability and growing market distrust were starting to spill over into their respective banking sectors. The effects for growth and employment would have been severe.

Indeed, investors were suddenly losing confidence that the euro area could survive in its current composition. The prospect that claims on governments and private companies in certain countries could not be discharged in euros had become a possibility.

Our response was to introduce the programme of Outright Monetary Transactions (OMT), which allows for *ex ante* unlimited interventions in sovereign debt markets. OMT has been effective in restoring market functioning and trust in the euro area.

For example, since the OMT announcement, bond markets have steadied, providing discipline without becoming destructive. Spreads on long-term bonds for Spain, Italy and Ireland have declined by around 150–250 basis points, and for Portugal by almost 500 basis points.

And this has helped reduce financial fragmentation within the euro area, as shown by the best indicator we have for fragmentation, the level of Target balances. These have declined by 285 billion euros, or 25%, since the peak last year. France, like all other member states, has benefited significantly from this stabilisation.

In short, the ECB has been very active in responding to the crisis. We have robustly defended the stability of our monetary union and therefore of our money. And we stand ready to act again when needed.

However, it is important to acknowledge that there are limits to what monetary policy can achieve. This is not a question of the scope of our mandate. It is fundamentally about what different institutions are empowered to do.

One pertinent example is the current shortage of credit for many households and small- and medium-sized enterprises. Credit provision requires funding, capital and a positive risk assessment. The central bank can help ensure funding and address macroeconomic risk. But it cannot provide capital, nor can it affect banks' assessment of the creditworthiness of individual borrowers.

Similarly, monetary policy cannot create real economic growth. If growth is stalling because the economy is not producing enough or because firms have lost competitiveness, this is beyond the power of the central bank to fix.

Yet, the euro area needs sustainable growth.

There are currently more than 19 million people unemployed in the euro area. Almost a quarter of young people are out of work. Such high levels of joblessness are a tragedy.

Moreover, a weak economy means fewer taxpayers and lower revenues. This puts pressure on public finances, and ultimately on our social models.

So what is the best way to achieve the growth Europe needs?

Let me turn to this issue now and share with you some reflections on this subject.

Growth and adjustment in the euro area

Some euro area countries have in the past relied on debt to support growth and fund social spending. But this path has led them to a difficult situation today. They have ended up with high public debts while growth has steadily fallen.

In this country, for instance, public debt has risen from around 20% of GDP in 1980 to over 90% of GDP today. In that time, annual GDP growth averaged 2.3% in the 1980s, 1.9% in the 1990s, and 1.8% in the 2000s up to the crisis.

This suggests that, for all euro area countries, a new approach is needed. An approach that can deliver growth and jobs, and sustain social models, without creating an unsustainable debt burden for future generations.

In my view, this requires two complementary responses.

The *first response* is to ensure that fiscal consolidation, which is necessary to contain debt levels, is made as growth-friendly as possible.

For instance, relying less on tax increases would help sustain citizens' disposable income. Prioritising capital investment over current spending would do more to lay the foundations for future growth.

Structural fiscal reforms, for example to pension systems, would also help support fiscal sustainability without negative effects on the economy today.

The *second response* is to raise competitiveness and increase the underlying productive capacity of our economies.

Here, the frontier is reforms that target the structure of the economy. These include reducing barriers to entry for new firms and young people, and removing burdens on business like complex tax and labour laws or distortionary regulations. Reforms to the labour market are also essential to create the highest possible opportunities for employment.

We are already seeing progress on rebalancing in the euro area: unit labour costs are coming down in countries where they had grown excessively; current account deficits are narrowing where there had been large imbalances in the past; and export growth is generally picking up in countries under strain.

But in many euro area countries, the gap between wages and productivity is still out of line with competitiveness. To increase employment, this gap should be closed and all the many policy levers that can contribute to this should be used. Changes to two-tier employment systems that protect insiders and harm outsiders are one such lever.

Let us not forget that those who suffer the most from unreformed labour markets are often young people, as evidenced by the very high levels of youth employment today. I therefore welcome the joint initiative of the French and German Labour ministers to tackle this issue.

This underscores an important point about reforms: by restoring competitiveness and creating opportunities for a wider range of people, they benefit the many, not the few. Reforms are an expression of solidarity between citizens. Solidarity *across* countries is also important, but it would be meaningless without solidarity *within* countries.

Building a stronger EMU

What role can the euro area as a whole play in supporting growth and stability across Europe?

Governments are today reflecting deeply on this question. They are considering what was missing in the original design of Economic and Monetary Union (EMU): what responsibilities need to be shared at the European level, and what not, to make EMU function effectively.

In my view, this debate should be driven by a single question: how can we best protect the vital interests of euro area citizens? And where the answer involves transferring sovereignty to the European level, we should not hesitate to do so.

The best example of this is Banking Union.

Banking Union is essential to ensure that we make permanent the progress made in reintegrating financial markets; that financial conditions in both core and periphery countries return to normal; and that our monetary union becomes truly single again.

It has two indispensable elements: a strong Single Supervisory Mechanism (SSM) and a strong Single Resolution Mechanism (SRM).

A strong system of common supervision is key to increase confidence in the health of euro area banks, which has been damaged due to supervisory failures in the past. Progress is already well underway here, and the Single Supervisory Mechanism will take over supervision one year after the legislation is adopted.

But to ensure that common supervision is credible, it needs to be accompanied by a mechanism that can wind down failing banks without causing financial instability. This is why we need a Single Resolution Mechanism. And it needs to have a strong European dimension to be able to deal effectively with large, cross-border banks.

But Banking Union is not the only example of where closer union is needed. Ultimately, the euro area needs to be drawing closer in all fields of economic policy.

The recent call from the leaders of France and Germany for closer economic union shows that this message is being understood. But it is important that form is fully aligned with substance. In my view, a true economic union means three things.

First, it means every country ensuring its national economy functions properly, without external imbalances and high unemployment. We cannot have a strong economic union without strong national economies.

Second, it means transferring some sovereignty over decision-making to the European level – accepting decisions that are made for the good of the euro area as a whole, even if, at that moment in time, individual countries may disagree with them.

Third, it means applying the same rules to all members of monetary union. This is not only a condition of fairness between countries, but also a pre-condition for deeper integration. Only if there is trust that each member will play by the rules can a union of mutual solidarity become possible.

For these reasons, moving towards closer economic union also requires an equivalent deepening of political union. Greater authority at the European level must be matched by greater democratic legitimacy. And here both the European Parliament and national parliaments have a key role to play.

As Herman van Rompuy has reminded us, national parliaments have become EU institutions.

Conclusion

Let me now conclude.

The euro area has made much progress in recent years, but it still faces many challenges. Solving them requires EU institutions and national governments to work in concert.

The ECB has done as much as it can to stabilise markets and support the economy. Now governments and parliaments need to do all they can to raise growth potential, strengthen competitiveness and build a stronger, more stable EMU.

I was impressed to learn that, back in 1871, Victor Hugo called in this Assembly for a United States of Europe.

France today can be equally ambitious in taking the euro area forward.

Thank you for your attention.