Benoît Cœuré: Time for a new Lamfalussy moment

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Professor Lamfalussy Commemorative Conference, Budapest, 1 February 2016.

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I would like to thank Lucas Guttenberg for his assistance in preparing this speech. All views expressed herein remain mine.

Summary

Recalling the crucial contribution of Alexandre Lamfalussy to European integration, Benoît Cœuré calls for a new method to accelerate this process at a commemorative conference in Budapest today. The fact that Europe is facing so many challenges should not discourage Member States from integrating further. On the contrary, says Benoît Cœuré, countries sharing the euro should show they are able to go forward in a unified manner. A successful euro area is crucial for a successful European Union. A strong political commitment to complete the Economic and Monetary Union (EMU) is also needed to strengthen the recovery and spur investment. It will show the public, business and markets that we are serious about make the euro a success. In the end, there will be no sustainable economic convergence without a political convergence, which implies a common understanding of what economic and fiscal policies look like in a monetary union. This is a root cause of why the spirit of the common rules is not sufficiently implemented. The moment has come to structure the process of integration in a new manner. This means putting the debate on European integration back where it belongs – in the political arena.

Dear Governor Matolcsy,

Ladies and Gentlemen,

Almost to the day 15 years ago, on 15 February 2001, Alexandre Lamfalussy and his Committee of Wise Men submitted their Final Report on the Regulation of European Securities Markets to the Commission.[1] To deepen integration in the Union's financial markets, they proposed to distinguish between the political choices and the more technical measures in the area of financial legislation; the former would be made by the legislators themselves, while the latter would be left to technical bodies. The intention was to significantly streamline the legislative process in order to ensure that the Union's legal framework for financial services was keeping up with the rapidly changing realities on the ground. The offspring of the Lamfalussy Report is today's European System of Financial Supervision, comprising the EBA, ESMA, EIOPA and ESRB.

Lamfalussy and his colleagues had realised that there are moments when one has to shift gears and change the method in order to progress. It was the right time, an auspicious moment – or *kairos* as the ancient Greeks called it – to make a change.

I will argue that today that we have reached another such *kairos*, that we are at a point where we should consider changing our method again. Economic and Monetary Union (EMU) needs a Lamfalussy moment, a moment when we realise that our current approach to moving European integration forwards is no longer good enough, and that we should seek new solutions.

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[1] Lamfalussy, A. *et al.*, "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", Commission of the European Communities, 2001.

In 2000, aiming for new solutions meant developing new ways of tackling technical standards. This time, our goal should be to design a *political* strategy to broaden the scope of integration so as to make EMU truly sustainable; to achieve this, we will need new political convergence to accompany new economic convergence.

To explain my thinking, let me first turn to the economic recovery and how to consolidate it; and second, how shifting gears with regard to completing Economic and Monetary Union could help to improve the situation in which we currently find ourselves.

A challenging time for Europe

At this conference a year ago, I argued that Lamfalussy had been right to claim early on that Economic and Monetary Union implied interdependencies which needed to be governed robustly. I also acknowledged that we had certainly not reached that point.[2] Indeed, 2015 provided us with numerous examples of the deficiencies of our governance framework. Negotiations with the Greek government went on for months, exposing the shortcomings of our institutional architecture in addressing collectively what was a collective problem – securing Greece's future in the euro. In parallel, the economic and fiscal policies of individual Member States did not do enough to complement the impulse coming from our very accommodative monetary policy stance, leaving euro area growth until recently far below its potential, and far below what would be needed to secure the future of our unemployed young people.

But 2015 was also the year when our countries' focus shifted away from the unresolved economic issues and towards the global challenges that Europe is facing. It is not for me as a central banker to comment on matters such as migration policies. Nevertheless, allow me two remarks:

Many of the challenges with which the Union is confronted – be they refugees, be they terrorism, climate change, or the state of the economy – point to the fact that we need to strengthen our capacity to work together in a spirit of joint responsibility. What frightens the public and markets alike is that Europe seems too often unable to act in a unified manner. Hence, I am convinced that if we can advance in one area and show that we can act jointly, this will help us to work together in other policy areas as well.

And we should be under no illusions: if downside risks to the recovery were to materialise, this would not make it easier to respond to the refugee crisis or to counter terrorism. Therefore, the fact that Europe is facing pressing challenges in other policy areas should not discourage us from progressing as regards Economic and Monetary Union. On the contrary, an economically successful euro area is crucial for a successful European Union.

Ingredients for a structural recovery

At the ECB, we have always made it clear that we are ready and able to play our part in the recovery. This means ensuring stable prices – which means inflation being below, but close to, 2% in the medium term. Price stability acts as a foundation on which the economy can grow. This was the rationale behind the ECB embarking on large-scale public sector purchases one year ago. And this was also the rationale for our re-calibration of the purchase programmes in December.

The euro area numbers clearly show that our monetary policy is having the intended effect.[3] It represents a major contribution to the ongoing cyclical recovery. And the Governing Council

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2 See Cœuré, B., "Lamfalussy was right: independence and interdependence in a monetary union", lecture at the Lamfalussy Lecture Conference, Magyar Nemzeti Bank, Budapest, 2 February 2015.

3 See ECB, "The transmission of the ECB's recent non-standard monetary policy measures", Economic Bulletin 7/2015, pp. 32-51, December 2015.

will review and possibly reconsider its stance when it meets in March. But for the recovery to become structural – and thus to increase growth potential and reduce structural unemployment – monetary policy does not suffice.

I have recently explained elsewhere that rebalancing in the euro area has come a long way since the start of the crisis, but is not finished yet.[4] The challenge now is to further consolidate the recovery and the rebalancing of the economy.

In my view, three ingredients could make a difference here:

First, more flexible economies to ensure that adjustments can take place via market mechanisms.[5] This means making the most of a low-interest rate environment to embark on structural reforms. These will not only increase growth tomorrow by boosting productivity and employment, but also will send a signal of confidence and unleash investment opportunities today.[6]

Which leads me to the second ingredient: higher levels of investment. Since the beginning of the crisis, investment has shrunk markedly. Of course, we should be careful not to assume that investment levels right before the crisis were desirable, as they partly reflected exuberant behaviour. But despite the current low interest rate environment, we are still well below the average numbers for the period 1995-2005 for both public investment and private investment.[7] This shows that an essential ingredient for sustaining the recovery is still missing.

And third, which brings me back to my call for a Lamfalussy moment, a strong political commitment to complete Economic and Monetary Union so as to give the public, businesses and markets a strong signal that we are serious about making the euro a lasting success.

Given that today's conference is in honour of Alexandre Lamfalussy, I'll focus the rest of my comments on that last point – completing EMU.

The Five Presidents' Report, which was published last summer, provides a very useful roadmap for moving ahead. However, discussions in recent months have shown that not everyone agrees on the need to complete EMU.

Nevertheless, in my view we might be able to agree, for a start, on three principles that could guide future work towards a complete Economic and Monetary Union and that strongly reinforce the proposals made in the report. These principles are as follows:

Risk sharing and risk reduction – a parallel approach

First, risk sharing and risk reduction should go hand in hand – both as regards strengthening the banking union and as regards economic and fiscal policies.

Think of it as being like building a house. Of course you will want to take all the necessary precautions to prevent fires, and you will want your neighbours to do the same. But even with the best precautions, you will probably still want to buy fire insurance, and rightly so. And if you buy it together with all your neighbours, it will be much cheaper.

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4 See Cœuré, B., "Rebalancing in the euro area: are we nearly there yet?", speech at Danish Economic Society in Kolding, 15 January 2016.

5 See Cœuré, B., "The future of Europe: building on our strengths", speech at the plenary session on "The Future of Europe" during the fifth German Economic Forum in Frankfurt am Main, 6 December 2013.

6 See Cœuré, B., "Structural reforms: learning the right lessons from the crisis", speech at the Economic conference organised by Latvijas Banka in Riga, 17 October 2014.

7 Public investment in the euro area was 3.2% of GDP for 1995-2005 compared with 2.6% projected for 2016, while private investment in the euro area was 18.7% of GDP for 1995-2005 compared with 17.3% projected for 2016. See European Commission, Annual Macroeconomic Database, 2015.

The same logic applies to EMU. Risk reduction on its own will not be sufficient; we will need to better share the remaining risk as well. The two are complementary.

For banking union, this means reducing risks in banks *in parallel* to establishing a common deposit insurance scheme and a robust fiscal backstop. This is what the Commission has proposed, and this is why we support their approach.

When we speak about fiscal and economic policies, combining risk sharing and risk reduction means that more pooling of fiscal resources – which I believe is ultimately necessary to provide better insurance against shocks – will have to be accompanied: (i) by a new convergence process which ensures that all economies have a similar resilience to shocks; and (ii) by initiatives to restore the credibility of our fiscal rules. These two elements are all about preventing risk sharing from becoming a one-way street, in other words preventing risk sharing from turning into risk shedding.

Joint decision-making on matters of common concern

The second principle we might be able to agree on is that there are policy domains where coordination via rules has run its course and is no longer a viable substitute for joint decision-making within common institutions. The argument here has two parts:

On the one hand, there should be no doubt that the rules that are in place have to be respected. This is not some kind of theological dogma. This is because it is economically and politically the right thing to do – not only to avoid the macroeconomic instability stemming from excessive imbalances, but also to re-establish mutual trust, which is the precondition for progress. Think about the high public debt levels of many Member States. If we want to be able to tackle the next crisis and have sufficient fiscal room for manoeuvre, strictly applying the rules of the Stability and Growth Pact today is both logical and imperative.

But on the other hand we have seen the political limits of the rules-based framework. Every time the rules are set to bite, national interests prevail over those of the euro area. This is built into the framework: as long as economic and fiscal policies are in the end a matter of national competence and as long as commonly agreed rules are perceived as an intrusion into policies that are seen as genuinely national, the interests of the euro area as a whole will probably not be strong enough to carry the day unless a country is forced to enter a financial assistance programme.

Therefore, we will, in the end, have to accept certain economic and fiscal policies in the euro area as truly shared competences, as the internal market already is; others, which are not essential for the smooth functioning of EMU, should remain solely a national competence. Hence, such a step should certainly not mean centralisation at European level for each and every policy. But it should mean that in those policy areas that are crucial for the functioning of EMU common legislation and policies will be needed where appropriate and warranted to ensure the primacy of the common interests of the euro area.

Such legislation and policies will in turn necessitate the further development of our institutional architecture. One element here will be to strengthen the euro area executive with a euro area treasury, be it within the Commission or as a separate body. Another element will be to build up a genuine legislative capacity at euro area level and to make institutions acting in the euro area's interest, such as the European Stability Mechanism, accountable to it.

The Lamfalussy moment – making the debate on EMU political

And then there is a third principle on which I hope agreement can be found, namely that we will see sustainable economic convergence only if accompanied by political convergence. Why is that so? It is because discussions on economic governance in the euro area in recent years have revealed that we still have no common understanding in Europe of what economic and fiscal policies should look like in a monetary union.

A common understanding of the aim of monetary policy did develop when the monetary union was being set up; today, we have a clear and broadly shared consensus that the ECB should first and foremost pursue price stability. We have seen a similar approach and attitude increasingly being taken to financial regulation.

But this is not necessarily the case for those policies which, as I just mentioned, remain largely in the national domain but subject to European coordination. This is no coincidence. Monetary policy and banking supervision are inherently technical and seemingly distant from the lives of ordinary people, whereas labour market institutions, product market regulations or the quality of a country's administration are not at all like this, as they affect the everyday lives of individuals.

The diversity of opinion on economic policy is a sign of a healthy, pluralist democracy and certainly not a problem. At national level, institutions and procedures exist which permit divergent views to be channelled into political decisions that leave little room for ambiguity.

There are, as yet, no procedures or sufficient incentives to facilitate a consensus on the design of economic policies in a functioning economic and monetary union. This is a root cause of why the spirit of the common rules is not sufficiently respected – as there is no consensus on what this spirit ought to be.

Our methods of advancing European integration have so far not been sufficient to foster such a consensus – hence we need a Lamfalussy moment and a shifting of gears.

This would mean putting the debate on European integration back where it belongs – in the political arena.

We are at a point where integration cannot and should not continue as a technical and technocratic exercise. It is now time for political leaders to take up the baton, because only they will be able to convince their electorates of the need for further deepening.

Therefore, as I said earlier, new economic convergence will need to be complemented by political convergence. Such a process would, in an inclusive and democratic way, ensure that, in parallel to converging economically, we would develop a common understanding of economic policies in the euro area that would underpin our common rules.[8]

Such a political process might not lead to the best outcome from our point of view as economists. But this would be a price worth paying if, in return, the outcome is a consensus that is fully democratically legitimised.

Conclusion

Let me conclude by saying that it is not my role to prescribe how such a process could be structured. But as long as we continue to speak the language of the insiders and remain vague, we will not engage citizens in a debate on the right economic policies for the euro area. I can perfectly understand why political leaders do not want to face their electorates and defend a euro area fiscal capacity when even we, as experts, cannot really agree on its definition.

When presenting his preliminary report, Lamfalussy argued in 2000 that the Union had a clear choice "either to dawdle aimlessly along in our slowcoach, in the slow lane – with … the world passing us by, or to change and capture the benefits".[9] I could not have found a more fitting description of the situation we find ourselves in now.

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8 See Cœuré, B., "Towards a political convergence process in the euro area", speech at the Interparliamentary Conference "Towards a Progressive Europe" in Berlin, 16 October 2015.

9 Summary of remarks made by Alexandre Lamfalussy, Chairman of the Committee of Wise Men on the Regulation of European Securities Markets, to the Press concerning the Committee's initial report published on

Thank you for your attention.

9 November 2000 (http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/lamfalussy-summary_en.pdf)