Benoît Cœuré: The future of the euro area

Remarks by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at Le Cercle Europartenaires, Paris, 21 March 2016.

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The footnotes can be found at the end of the speech.

President Guigou,

Minister Jeanneney,

Ambassador Meyer-Landrut,

Excellencies,

Ladies and gentlemen,

Thank you for inviting me here.

This morning I would like to share with you some thoughts which echo your association's motto "Acting for Europe with Europeans".

Role of the European Central Bank

"Acting for Europe with Europeans" could also be the ECB's motto. One of its strengths is indeed its European mandate. The Governing Council takes its monetary policy decisions in the interest of the euro area as a whole, with a view to ensuring price stability. As a *quid pro quo* for its independence, the ECB is accountable for its actions to the people's representatives, who are elected to the European Parliament by direct universal suffrage.

At a time when so many European citizens express doubts about Europe, the duty of European institutions is to strengthen their legitimacy both by reinforcing their democratic accountability and by showing that they meet the objectives they've been entrusted with.

Regarding democratic accountability, it would be wrong to underestimate the importance the ECB places on its relationship with the public. Recent studies show that people's knowledge and understanding of the objectives and principles of monetary policy influence inflation expectations[1] as well as trust in the European Central Bank.[2] At the same time, these studies indicate that the level of knowledge and understanding can be further improved. We have taken several initiatives in this area in the last years, such as publishing the accounts of our monetary policy discussions and the diaries of the Executive Board members. But we can certainly do more to facilitate the understanding of the ECB's role and policies by the general public.

Rebuilding trust in Europe implies above all that European institutions deliver on the objectives which have been assigned to them as part of their mandates. During the crisis, the ECB did not hesitate to act decisively.[3] To preserve price stability, we have adopted an accommodative monetary policy stance that has no precedent. Our measures, whether standard (i.e. relating to the key interest rates) or non-standard, have achieved several objectives.

- They have supported demand for goods and services in the euro area. As the ECB's President recently stated[4], our models show that half of the recovery in the euro area (as a percentage of GDP) in the past two years is attributable to our monetary policy and half is mainly the result of lower oil prices.
- Our monetary policy has also improved financing conditions and remedied financial fragmentation. As a result of our non-standard measures, credit conditions have improved across the euro area[5]: from May 2014 to January 2016, interest rates on loans declined significantly (by 84 basis points for non-financial corporations and by

68 basis points for households). Furthermore, the steepest decline observed was in the most fragile economies of the euro area.[6]

- Finally, our decisions have helped maintain trust in the single currency in a context of financial instability and high uncertainty. Indeed, not only has market confidence in the euro remained strong, but public confidence has too: according to Eurobarometer data, trust in the euro is virtually unchanged compared to its pre-crisis level.[7]

The measures we announced on 10 March 2016 form a very substantial package which gives priority to loans for households and businesses, and thus supports the recovery. They underline our determination to fulfil the mandate entrusted to us by the people of Europe: to bring inflation back to nearly 2%, and they show that we have no shortage of tools.

But the ECB cannot single-handedly create the conditions for a sustainable recovery in growth. This requires a concerted effort in terms of economic and fiscal policies. While unemployment started to decline in the euro area in January (10.3% compared with 11.9% two years earlier), ambitious reforms are still needed in most of the euro area economies, given the low growth potential and high structural unemployment. The measures to raise productivity and to improve the business environment, including public infrastructure, are essential to increase investment and boost job creation. It's true that there is limited room for manoeuvre in terms of using fiscal policy to support growth, and the fiscal rules cannot be stretched to the point where they would lose all their credibility. But while some countries have such margins under the Stability and Growth Pact (which they are already partly using to support refugees), *all* countries can make their tax structures more favourable to growth and redirect public spending towards investment, research and education.[8]

Our monetary policy provides a favourable context for these reforms.[9] It is sometimes argued that our monetary policy discourages governments from undertaking the necessary reforms. For one thing, this idea is belied by the facts: were these reforms carried out when interest rates were higher? Also, it fundamentally conflicts with the set-up of the euro area, which gives the ECB a narrow mandate focused on price stability. The ECB's role is not to police fiscal and structural policies. It's up to governments to do it with impetus from the Commission.

The progress necessary for Economic and Monetary Union

We must also continue working to strengthen Economic and Monetary Union in order to increase its resilience to economic shocks. This is in our economic interest, of course, but it's also a factor in terms of political stability. Uncertainty, polarisation and political fragmentation increase substantially in the aftermath of financial crises[10]. Such uncertainty is harmful, economically speaking[11], and tends to make crisis resolution more difficult.

The crisis we've just gone through is no exception. Across Europe, it led to a decline in confidence in the European institutions. The intergovernmental dimension of European decision-making mechanisms has also led to a polarisation of positions among Member States, stirring up nationalistic impulses and hampering decision-making[12]. Maintaining this approach would prevent the establishment of a common growth strategy and condemn us to a future of low growth and repeated crises.

However, significant progress has been made as Member States remain determined to preserve the integrity of the euro. In particular, the euro area has adopted a crisis resolution mechanism (the European Stability Mechanism) and has developed financial, fiscal and economic supervisory tools. It has also created the Single Supervisory Mechanism for banks, which has been entrusted to the ECB, and a resolution mechanism for banking crises supported by a Single Resolution Fund.

However, there is still much work to be done to tackle the vulnerabilities that persist in certain Member States. The country-specific recommendations, which each year identify the key objectives to tackle these vulnerabilities, are hardly or not at all acted upon.

The time has come to initiate a new economic convergence process, thus relaunching the convergence efforts that each euro area country agreed to prior to adopting the single currency[13]. After its adoption, these efforts dwindled and, before the crisis, we saw a divergence in terms of inflation levels, unit labour costs, current account balances and levels of GDP per capita[14]. The abrupt adjustment necessitated by the crisis showed the economic and social cost of this divergence.

Political convergence is a necessary condition for economic convergence[15], as it implies making economic and fiscal policy a shared competence in the same manner as policies relating to the internal market. This is particularly true for France and Germany, whose cooperation is a driving force. The idea isn't to always move towards harmonisation, but rather to give ourselves the option to adopt common solutions where it makes sense to do so – a common framework to manage insolvent businesses and households could, for example, facilitate the resolution of non-performing loans and contribute to the development of cross-border investment.

Relaunching the economic convergence process is also essential if we eventually want to set up a fiscal tool to absorb shocks at the euro area level, without creating the risk of permanent, one-way transfers, which are not part of the euro area's initial "contract". As I said elsewhere, this is about establishing a new European social contract, which can only be designed under John Rawls' "veil of ignorance"[16]. The private sector component of risk-sharing is also extremely important – in the United States, the capital and credit markets act as a buffer for around two-thirds of economic shocks[17]; flexible economies and the free movement of goods, services and workers are necessary conditions for the smooth functioning of the monetary union. Again, however, risk-sharing must be accompanied by a common framework that avoids excessive risk concentration. This is the essence of the ongoing debates concerning the European deposit guarantee scheme and the Capital Markets Union.

This economic convergence process could include a timeline and clearly defined milestones, and would ultimately bring about deeper integration in the fiscal sphere and the creation of shared fiscal tools. The management of these tools, including the European Stability Mechanism, could be entrusted to a euro area treasury that is accountable to the European Parliament. Defining its mandate and its tools is a political issue that presupposes a democratic debate[18].

Ladies and gentlemen,

The progress of European integration has increased interdependence between Member States. But we still haven't drawn all the necessary conclusions and European politicians still don't have the tools that would allow them to respond to the expectations placed on them. This shortcoming feeds popular frustration with European policies, sometimes to the point that they question European integration itself. There is nothing inevitable about the status quo, but, to move forward, we need to redefine a common project. It will take many years to implement this project. It is all the more urgent to start defining it.

Thank you for your attention.

[1] Carvalho, C. and Nechio, F. (2014), "Do people understand monetary policy?", *Journal of Monetary Economics,* 66, 108-123; van der Cruijsen, C., Jansen, D.-J. and de Haan, J. (2015) "How Much Does the Public Know about the ECB's Monetary Policy? Evidence from a Survey of Dutch Households", International Journal of Central Banking, 11, 169-218.

[2] Ehrmann, M., Soudan, M. and Stracca, L. (2013), "Explaining European Union Citizens' Trust in the European Central Bank in Normal and Crisis Times", *The Scandinavian Journal of Economics*, 115, 781–807; Hayo, B. and Neuenkirch, E. (2014), "The German public and its trust in the ECB: The role of knowledge and information search", *Journal of International Money and Finance*, 47, 286–303.

[3] A more detailed discussion of the measures taken during the crisis can be found in B. Cœuré, "Consolidating the euro area's economic recovery", introductory remarks prior to an informal exchange of views with the European Affairs Committee and the Finance Committee of the National Assembly, Paris, 13 May 2015.

[4] Committee on Economic and Monetary Affairs of the European Parliament, Monetary Dialogue with Mario Draghi, President of the European Central Bank, 15 February 2016.

[5] See also "Results of the January 2016 euro area bank lending survey", 19 January 2016.

[6] Between May 2014 and January 2016, the composite rate of bank borrowing for non-financial corporations has fallen by 62 basis points in Germany, 46 in France, 111 in Spain and 130 in Italy. For households, the composite rate of bank borrowing has fallen by 65 basis points in Germany, 77 in France, 98 in Spain and 100 in Italy.

[7] The Standard Eurobarometer 84 survey published in December 2015 indicated that 68% of respondents trusted the euro (26% did not trust it), which is the same level as at the end of 2006.

[8] In the euro area, the share of GDP accounted for by public investment fell from 3.2% in 2007 to 2.6% in 2015. The share of the total primary public expenditure accounted for by public investment also fell from 7.6% in 2007 to 5.8% in 2015.

[9] Recent empirical research shows that an accommodative monetary policy stance strengthens the positive effects of structural reforms and increased investment in public spending. See Bordon, A.R., Ebeke, C. and K. Shirono, "When Do Structural Reforms Work? On the Role of the Business Cycle and Macroeconomic Policies", IMF Working Paper, No. 16/62, March 2016, and "Public investment in Europe", ECB Economic Bulletin, Issue 2, 2016, forthcoming.

[10] Funke, M., M. Schularick and C. Trebesch (2015) "Going to extremes: Politics after financial crises, 1870–2014", CEPR, Discussion Paper No. 10884.

[11] Baker, S.R., Bloom, N. and S. J. Davis (2015), "Measuring Economic Policy Uncertainty", NBER Working Paper No. 21633.

[12] See B. Cœuré, "Drawing lessons from the crisis for the future of the euro area", speech at "Ambassadors Week", Paris, 27 August 2015.

[13] "Completing Europe's Economic and Monetary Union", report by J.-C. Juncker, in close cooperation with D. Tusk, J. Dijsselbloem, M. Draghi and M. Schulz, 22 June 2015.

[14] Real convergence in the euro area: evidence, theory and policy implications, ECB Economic Bulletin, Issue 5, 2015; Auf dem Brinke, A., Enderlein, H, and J. Fritz-Vannahme (2015), "What kind of convergence does the euro area need?", Gütersloh: Bertelsmann Stiftung and Jacques Delors Institut – Berlin.

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

[16] See B. Cœuré, "Drawing lessons from the crisis for the future of the euro area", speech at "Ambassadors Week", Paris, 27 August 2015.

[17] Asdrubali, P., Sørensen, B. E. and Yosha, O., "Channels of interstate risk sharing: United States 1963–1990", Quarterly Journal of Economics, 111(4), 1996.

[18] See B. Cœuré, "Time for a new Lamfalussy moment", speech in Budapest, 1 February 2016.