François Villeroy de Galhau: The future of Europe – a central banker's view

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, before the Hearing of the Committee on Economic and Monetary Affairs of the European Parliament, Brussels, 28 September 2016.

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Mr Chairman,

Honourable Members,

I would like to thank you for welcoming me here today in this institution which is the embodiment of European democracy. I particularly wanted to come and exchange views with you during the first year of my mandate. Furthermore, I am speaking to you two days after Mario Draghi. I would like to start by focusing on an issue that concerns us all: the future of Europe. And, as a central banker, I would like to approach this question in economic terms.

At present Europe is not doing well, at any rate not as well as it could. Eight years after the crisis its economic performance is still disappointing. The recovery is underway, but it is too slow: even though the promising results in some countries show that there is no inevitability about outcomes in Europe, overall growth is levelling off. This is having real consequences: the scourge of unemployment continues to afflict over 21 million people; 16 million in the euro area alone. This is compounded by growing Euroscepticism as evidenced by the victory of the Brexit camp, even though this also had specifically British causes. All too often, the European Union is no longer seen as a solution, but as another problem to add to the many difficulties we already have to face. And our differences of opinion tend to overshadow areas where we share common ground.

Yet I believe that we need more than ever to remain proud of our European identity. Our identity is more than our great history of reconciliation, more than our rich diversity. Our common identity is a unique social model combining high standards of public service and relatively low levels of inequality – much lower than in American society. And this has been achieved in a market economy: indeed, the hallmark of Europe is a social market economy. At a time when concerns are being raised over the fate of those in many parts of the world who have been left behind by globalisation, this is not the moment to abandon our common model or to lower our European flag.

But this ambition must be clear-sighted. To assert our social model inaction is not an option; we need newfound confidence and stronger growth. In economic terms, this means building on our dual strengths and leveraging their full potential through three projects.

We have ***two major strengths*** in Europe:

– We have built a large ***single market***. It is a tremendous asset which belongs to us all. It is no coincidence that access to the single market lies at the heart of the Brexit debate. We cannot prejudge the outcome of the future negotiations, but access to the single market must continue to go hand-in-hand with strict acceptance of all the usual European Union rules: there can be no cherry-picking or free-riding.

– We have also built a solid currency in the ***euro*** which is recognised worldwide. The great majority of euro area citizens (68%) are attached to their currency. Within the ECB Governing Council, we take very seriously the task entrusted to us by the Treaty on the Functioning of the European Union of maintaining price stability. In practical terms, this means that inflation should be neither too high nor too low which was the greatest danger in recent years. In a world of uncertainty, European monetary policy is today a yardstick of stability. And it has produced tangible outcomes: it is boosting demand – by between 0.3% and 0.5% per year – as well as inflation. Inflation should exceed 1% in early 2017 and rise to 1.6% in 2018. But although we have succeeded with monetary union, much remains to be done for economic union. It is precisely for this reason that we have actively used monetary policy, but we have failed to follow it up sufficiently with other economic policies.

Building on these dual strengths, Europe's quest for growth must, in my view, follow the path of ***three concrete projects***, three steps.

First step: as of today, Europe needs what I prefer to call a real "***Financing and Investment Union"*** (FIU), rather than just a "Capital Markets Union". Why? Because there are still firms in Europe today looking to invest and innovate but which cannot find the appropriate financing. And yet resources are not lacking: in the euro area, the current account surplus, which is a measure of the gap between savings and investment, stands at more than 3% of GDP. This is huge. This trend is often described as a savings glut but I believe it is more fitting to talk of an investment dearth, since the solution for closing the gap is not to diminish savings; on the contrary, the solution is to increase productive investment. Indeed, the investment shortfall highlighted at the time the Juncker Plan was rolled out is still more or less equivalent to around 2% of GDP today.

In order to create this FIU, we need to build on the initiatives already in place: the Capital Markets Union of course, but also the Juncker Plan and the Banking Union. And this does not mean simply merging them together, but rather magnifying their impact through the creation of synergies. We need to gather together our existing forces – which are currently over-compartmentalised and split between the European Commission, the EIB, and even the ECB – and rally them behind a single objective: the creation of a vast European savings and investment market. This new framework would allow Europe to implement more ambitious initiatives. Let me cite just two examples.

Firstly, in the ***business world***: we need to make it easier for firms to finance themselves with equity rather than debt. Equity capital is the best way of financing innovation, which is by nature more risky. Yet Europe is lagging behind in this field: equity capital amounts to 52% of GDP in the euro area, compared with 121% in the United States – less than half as much. In practice, this will mean harmonising business insolvency laws, and ensuring standardised and more detailed financial information on SMEs. The second example concerns the financial sector: we need to allow more cross-border mergers within the euro area. Banks that are more European will be better able to shift savings across national borders. And to loosen the excessive link between sovereign debt and the domestic banking sector, one solution could be to create high quality euro area synthetic bonds (European safe bonds), backed by a diversified pool of sovereign debt securities issued by Member States. In this case, each Member State would retain sole responsibility for the issuance and repayment of its debt.

The second step for the euro area is a ***collective economic strategy***. When each state acts in isolation, we inevitably end up with a situation that is suboptimal for everyone. We blame each other for the deficits of the south and the surpluses of the north… and the end result is that our economic policies get stuck. In some cases, they are even held hostage to oversimplistic political posturing. But the answer does not lie in widespread fiscal stimulus, as a recent trend seems to suggest. On the contrary, we know that growth and employment will be stronger in Europe if we implement a differentiated economic strategy, with more structural reforms where they are needed, such as in France, and more fiscal support in those countries with room for manoeuvre, such as Germany. In practice, for this level of coordination to exist, the euro area needs an institution that fosters confidence, one that both embodies and nurtures the shared commitment of our Member States. This institution could consist of a "Finance Minister" who would be a member of the Commission and Chairman of the Eurogroup, and would be backed by a European treasury. He or she would be responsible for defining a collective strategy – which would then be ratified by the European Parliament – and for ensuring it was implemented in each country. The Minister would also be tasked with managing a reinforced ESM (European Stability Mechanism). As this step will mean modifying the existing Treaties, it can only reasonably come after the elections scheduled for next year in various euro area countries.

Lastly, the third and final step would be to complete the Economic and Monetary Union with a ***European fiscal capacity***. This would mean first increasing the sense of trust between Member States, to avoid it being seen as a one-way "transfer union". A genuine euro budget would be a stabilisation tool and could include, for example, a European-wide unemployment insurance scheme. It could also be used to finance certain "European public goods" such as digital technology, the energy transition or the integration of refugees. And in the long term, it would be directly able to raise taxes and issue common debt.

In conclusion, as a central banker and steadfast European, this is what I believe is needed for the future of Europe. As a central banker, of course, I know the decision does not fall to me. My responsibility as part of the Eurosystem is to assist in delivering a monetary policy that is in line with the mandate entrusted to us, and to make proposals so that other economic policies are more efficient and more complementary. Because monetary policy cannot do everything. Indeed the founders of the euro always made it clear that other stages would be necessary. I have given you an outline of my views, and I will be happy to answer any questions.