François Villeroy de Galhau: The euro - 25th anniversary of the Maastricht Treaty

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Osservatorio Permanente Giovani-Editori, Florence, 7 February 2017.

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Ladies and gentlemen,

I wish to sincerely thank the Osservatorio *Permanente Giovani-Editori* and its Chairman, Andrea Ceccherini, for inviting me. I am delighted to be with you this afternoon, with the young people of Italy, in a country that I love. A country that is at the heart of Europe and that has often marked its history, as illustrated by your magnificent city of Florence, and the glory of its Quattrocento, cradle of the whole European Renaissance. But a country that currently has doubts about Europe. I stand before you, following in the footsteps of Ignazio Visco, Jean-Claude Trichet, Jens Weidmann and Klaas Knot, as both a central banker and a committed European. And, on this 7th of February, I want to speak to you about the euro: today is the 25th anniversary of the signing of the Maastricht Treaty. The euro has existed now for 18 years and for the past 15 years it has replaced the Italian lira and the French franc in our wallets. I want to start by saying what the single currency has brought, in concrete terms, to the Europeans and then reply to four doubts that we often hear about the euro. Lastly, I want to talk about what remains to be done collectively in the future.

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I. The euro has brought us all four main benefits

Maastricht and the euro are naturally part of a broader history: the history of Europe, and its singular achievement of making the transition from war to peace. This history is just as topical in the highly uncertain world of 2017. Great Italians have counted among its key players, and not least Alcide de Gasperi or Altiero Spinelli. But I would also like to cite an almost unknown German, Josef Müller, founder of the Bavarian CSU, who was deported to a concentration camp during World War II; In 1946, he was one of the first to say: “We need a European currency, because countries that share a currency will never be at war”. In 1990–1992, the time had come: because German reunification required more European Union; and because the disintegration of the Soviet bloc brought the European continent back to the global arena. And so, from Rome in 1990 where we launched the intergovernmental conference – I remember the Palazzo Madama – to Maastricht in 1992, we created the euro. And others Italians have continued to be key players, from Tommaso Padoa-Schioppa to Mario Draghi today.

Our foundations are therefore partly political; but the European edifice also has sound economic foundations. And I now wish to discuss its four tangible and concrete benefits. These are the three advantages of a sound currency: price stability; financing stability; and exchange rate stability. And, this results in the euro being an internationally recognised currency.

- **Price stability, a prerequisite for purchasing power**

First, the euro makes it possible to genuinely maintain price stability, i.e. to control inflation. This is crucial to preserving household purchasing power and, in the face of uncertainties, to building confidence in the value of the currency.

Before the euro, inflation sometimes reached very high levels in Europe. In the 14 years preceding the euro (1985–1998), inflation gradually declined but remained above 3% on average, with major disparities across countries: 5.1% in Italy and 2.6% in France for example. In the 14 years since the creation of the euro, inflation has come down significantly – in the period between 1999 and 2012 inflation averaged 2% – but the disparities across countries also narrowed: over the same period, inflation in Italy was only 2.2%. We forget all too often the erosion of value – and thus of confidence – that inflation generates. Over the last 14 years of the lira, cumulative inflation had reached 98%; over the same length of time, with the euro, it is almost three times lower. As of 2013, inflation has even been too low in the euro area, and this is why the ECB has been successfully conducting an active monetary policy since 2014.

In practice, the ECB's target is an inflation rate below, but close to, 2% over the medium term. This definition has not changed since it was adopted in 2003 and is broadly shared today by all the main central banks of developed countries, including the United States and the United Kingdom. In the current environment, it is important to recall that monetary policy has an internal aim (keeping inflation under control), not an external aim (devaluing the exchange rate, which could trigger negative chain reactions). Why 2% and not 0%? In order to keep a safety margin, as inflation that is too low is as bad as inflation that is too high: it creates the risk of deflation, i.e. a general and lasting downward spiral of prices, which generates a fall in economic activity and a rise in unemployment. Furthermore, slightly positive inflation oils the wheels of the economy, for example when there are labour market rigidities or differences between regions of the euro area.

- **The stability of financing via the decline in interest rates**

Controlled inflation results in a fall in market risk premia: this leads to lower interest rates in the euro area, and especially narrower spreads between countries. Let us take the example of our respective countries. . Before Maastricht, between 1986 and 1992, the spread between Italy and Germany was 5.1% on average, while it was just 1.4% in 2016. Admittedly there were pressures in 2011–2012, stemming directly from temporary doubts over the sustainability of the euro area. For France, the spread has also narrowed, from 1.9% between 1986 and 1992 to 0.3% in 2016. The French spread may also temporarily react to political uncertainties, but remaining in the euro over the long term continues to be our best protection. All economic players are benefiting from lower interest rates: households – when they purchase a property – and companies that invest, as well as governments and hence taxpayers. Some critics would like to leave the euro to let deficits rise without being constrained by European rules. But that is wishful thinking: the financing of deficits would be much more costly for euro area countries leaving the single currency, if we were to return to the spreads before the euro.

- **Exchange rate stability and the strength of the single market**

The euro also helps consolidate the single market, which the European Member States have constructed step by step since the Treaty of Rome in 1957, 60 years ago. In order to achieve greater trade integration, it was necessary to reduce currency fluctuations: Europe first attempted this, as of 1979, with the European Monetary System, built on a common currency, the ECU. But this mechanism was insufficient to ward off speculative attacks: remember the severe crisis of September 1992 which forced the Italian lira out, making it lose 21% of its value, and which destabilised the European economy. The single currency put an end to these serious disruptions. It also considerably simplifies day-to-day life: there are no longer any conversion fees for individuals, or any more uncertainties relating to exchange rate volatility for companies. For many firms, including Italian imprenditori, their market naturally expanded from their domestic market to the whole of the euro area. According to empirical studies, the euro has thus led to a 5 to 15% increase in trade between Member States.

- **An internationally recognised currency**

The economic size of the euro area and the stability of its currency allow the euro to play an international role. Before the euro, in 1995, only the Deutsche Mark was an international reserve currency, with a share of 15% of global reserves. Today, our shared currency accounts for 20% of international reserves, in second place behind the dollar. An internationally recognised currency generates economic gains: the financial markets are more attractive for foreign investors, more liquid, and therefore more efficient. But it also carries a political weight: I know that when Mario Draghi speaks at the G7 or at the G20, the whole world listens to Europe attentively. In the global financial arena, which has become turbulent, this union is our greatest chance; none of our countries would have such clout in insolation. Our sovereignty relies necessarily on European sovereignty.

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The euro makes us more robust, and gives us more confidence in our currency: this is a considerable asset amidst so much uncertainty. The euro has naturally also provided us with a strong symbol of unity among European nations. Moreover, from 12 at the start, the number of participating countries has risen to 19 today: 7 countries decided democratically to join the euro, and none has wanted to leave it. These are the concrete economic benefits that make the 340 million citizens of the euro area attached to their currency, to our currency. This attachment, which has been measured since the outset, has remained strong throughout the crisis. 70% support the euro today, i.e. the highest level since 2008; a large majority of French citizens support the euro (68%). Support remains strong in Italy, albeit at a lower level (53%). The euro is not a technocratic utopia: it is a political and democratic decision, supported 25 years on – with hindsight – by a clear majority of citizens.

II. However, there are four doubts about the euro.

I will address them seriously, even though I think that these ideas are erroneous.

a) The euro is enemy of growth and employment

Some say that the euro acts as a brake on growth, employment, and competitiveness. However, at 1.7% in 2016, growth in the euro area was higher than US growth (1.6%) and above all there are major economic successes among euro area countries. Out of the 35 OECD countries, that with the second highest real GDP growth was Ireland at 4.3% in 2016, and Spain is also growing strongly, at 3.2%; the country with the lowest government debt at end-2016, was Estonia, at 9.5% of GDP; several countries in the area, including Austria and Germany, boast almost full employment, at between 4% and 6% in 2016; Estonia and Finland are among the top 3 countries in terms of science scores in the PISA test. So the euro is not to blame, it is the different national policies.

Admittedly, with the euro we have lost the tool of currency devaluation. Devaluation can have positive effects in the short term as it lowers the price of exports, but, in the medium term, it can have significant negative effects: it can exert inflationary pressure via the rise in import prices; it can make the country poorer, via the reduction in the value of its assets, and conversely the increase in its external debts; and lastly, it creates the risk of a trade war, with chain devaluations, as was the case in the 1930s. On average, we have a suitable exchange rate with the euro. But no lasting success in economic history has been built on a weak currency; all have been built on a good structural environment, corporate innovation, and a high level of specialisation among firms. Italian creativity, your commercial ingenuity, dating back to Venice, Genoa and Florence, count much more than the facility of a weak lira.

b) The euro is an "all-risks insurance" for all Member States

This view appears to be the opposite of the preceding one; in fact it stems from an equally false perception: attributing excessive evils or benefits to the euro. A currency is an essential nominal value; but this alone does not determine the real performance of the economy. In the first part of the 2000s, once it had acquired the collective gain of the euro, France and Italy, like many

Southern European countries, wrongly believed that it was possible to let up on competitiveness efforts, which are nonetheless an ongoing imperative – “there is no free lunch”. Today we are suffering the consequences: we have lower economic growth and employment than some of our neighbours, such as Germany and Spain, which succeeded in carrying out the reforms necessary for enterprise (corporate sector), employment, education and expenditure reduction (public sector).

Contrary to what some say, our lag in growth is not due to excessive fiscal discipline. The government debt to GDP ratio has more than doubled in Italy since 1980, and it has risen fivefold in France. When my generation was 18 years old, debt stood at 20% of GDP in France. For your generation today, it verges on 100% of GDP in France and in Italy stands at over 130%. We have failed when it comes to intergenerational solidarity and sustainable development. And as far as I am aware, neither France nor Italy has become a champion of growth in Europe. France and Italy are lagging behind today because of a lack of national reforms. The euro cannot and will never be able to replace them. And this is good news since it means that there remains much room for our domestic policies, our collective debates, and our creative efforts.

c) European monetary policy fosters inequality

For some, the ECB’s current low rates are generating social inequalities: savers who have put their money in fixed-rate products are being penalised by lower returns, while those who own shares or property are benefiting from the rise in asset prices. The reality is very different. First, because savers and asset holders are generally one and the same. Second, and most importantly, because this very piecemeal analysis ignores the macroeconomic impact of monetary policy, which benefits us all. Our measures create very favourable financing conditions, which are stimulating demand via consumption and investment, and speeding up the decline in unemployment. All this helps to reduce inequality, as unemployment tends to hit the poor and less-qualified the hardest. According to estimates, as a result of our actions, euro area economic growth was boosted by 1.5 percentage points between 2015 and 2018.

With regard to inequality, now is precisely the time for us Europeans to talk about our experiences. We all share the same social model – to which we are strongly attached – combining a high volume of public services with markedly less inequality than in other countries – for example in the United States. The right response to inequality, therefore, is not a change of monetary policy. And it is not more protectionism, even though the rules of global trade need to ensure the benefits are spread more widely. The correct response to inequality is to develop the right social model.

d) The euro is controlled by technocrats in Frankfurt

Yes, Frankfurt is in Germany… just as Brussels is in Belgium. But yes, despite this, the ECB belongs to us all: not just to the Germans – as the Italians tend to think – and not just to the Italians – as the Germans tend to think. With the Eurosystem, that is the ECB and the 19 national central banks, we have had a genuine federal system, one that works, since 1999. We take our decisions collegially, within the Governing Council, and then apply them in each of our member countries. ECB staff – at the heart of the system – only account for 5% of total Eurosystem headcount. France and Italy thus have much more say in decisions today: before the advent of the euro, de facto our monetary policies closely followed that of Germany.

In addition, to guarantee that we act in the general interest of the euro area, and not that of individual countries, the central banks of the Eurosystem are all completely independent and free from political influence. This independence is sometimes questioned, but it is a strength: we have to commit over the long term to serving the mandate entrusted to us – price and currency stability. This independence is therefore governed by a strict framework: a clear objective; an obligation to report results regularly to our citizens and to their elected representatives; and a democratic process for the appointment of all senior figures.

III. What remains to be done, tomorrow, collectively

The euro has brought great benefits, in the form of soundness, confidence, unity and sovereignty – as I have endeavoured to remind you. However, it also raises questions, which I have tried to answer, while at the same time underlining that the euro cannot be held responsible for everything that happens. But we have not yet come to the end of the road. We cannot ignore the rising tide of Euroscepticism in Europe, and the extreme case of Brexit. I particularly like this saying, attributed to Dante, one of the great citizens of Florence: “Some wait for time to change, others seize the moment and act.” But what direction should we take? Less Europe? That would be a mistake if we want to take collective control of our destiny in this new world – a world marked by direct criticism and unilateral action on the part of the new President of the United States. What we need is not necessarily more Europe, but rather a “better” Europe: a Europe that is less caught up in the detail, more focused on a few key priorities, and more efficient. A Europe that talks less and acts more: “Little, well, until the end.”

Of course, there are some non-economic areas: youth training – like Enrico Letta, I believe in the benefits of an Erasmus-pro programme for apprenticeships – climate change, defence and the protection of our borders, for example. On the economic level, we should be proud of our successes – our single currency, our single market and our shared social model. But to complete the success of our monetary union, it is vital that we make progress on our economic union. There are two concrete levers for achieving this .

- **A “Financing Union for Investment and Innovation”**

The first immediate step is a “Financing Union for Investment and Innovation” (FUII). Why? In those economies that are close to the so-called technological frontier, as is the case with France and Italy, innovation is the key to economic growth, and not just for start-ups. The problem is that, today in Europe, there are companies that want to invest and innovate, but that cannot find the right financing, notably equity capital. And yet it is not for lack of resources: the euro area has a savings surplus of more than EUR 350 billion, equivalent to more than 3% of GDP. That is huge. The FUII must make it possible to channel that abundance of savings more effectively towards investment.

To achieve this, we naturally need to build on the initiatives already in place at European level: the Capital Markets Union, the Juncker Investment Plan and the Banking Union. But we also need to foster synergies between them and go even further.

- **More reform at national level and a better collective economic strategy**

When each State acts without worrying about its neighbours, we end up in a situation that is sub-optimal for everyone. There is no doubt that growth and employment would be stronger in the euro area if its members committed to implementing more structural reforms where they are needed, such as in France and in Italy, and to providing more fiscal or wage support where there is room to manoeuvre, such as in Germany. But for that to happen, we need to rebuild the trust between member countries. First by accelerating reforms at home – in France and in Italy – and let me be clear, it is in our national interest. And then, in order for this collective strategy to exist, the euro area needs an institution that inspires confidence, one that embodies and brings to fruition the shared commitment of our Member States. This institution could consist of a democratically legitimate euro area “Finance Minister”. It could also – subject to certain conditions – have a European stabilisation budget to enable it to cushion any economic shocks in Member States; one possible solution, which remains to be discussed, could be a shared unemployment insurance scheme, as suggested by Finance Minister Pier Carlo Padoan.

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Allow me to conclude with the words of Carlo Azeglio Ciampi, that great Tuscan and President of the Italian Republic, who unfortunately passed away just recently. “What has been achieved [in Europe], in both the economic and political spheres, seems too important each time to be put at risk: it is so important to give governments and citizens the courage to make further steps forwards […]. In this sense, the creation of the euro is not only an end point but also a starting point.” The euro has never been easy but it is not a self-imposed straitjacket – rather it is a political and historical ambition. In these troubled times for Europe, we need both to buttress this vital asset and to build on it for the future. We have to do it for your generation, because you are the hope for Italy and for Europe. But more than that, we need to do it with your generation. Thank you for your attention.