# Benoît Cœuré: The perils of isolation

Speech by Mr Benoît Cœuré, Member of the Executive Board of the European Central Bank, at the Council on Foreign Relations, New York City, 19 April 2017.

* * *

*I would like to thank J. Beirne, M. Ca' Zorzi and M. Grill for their contributions to this speech. I remain solely responsible for the opinions contained herein.*

We are currently seeing widespread concerns in many parts of the world regarding free trade and globalised finance. These concerns mainly stem from perceptions of inequality of opportunities and a lack of inclusiveness in sharing the benefits of international openness, resulting in growing disparities in income. Often, these are not only perceptions. In this country, for example, net income inequality has been on an upward trend since the late 1970s.[1]

Although globalisation might have amplified growing income inequality, empirical analysis tends to suggest that technological progress, and the associated rise in demand for skilled labour over low-skilled, is likely to explain most of the rise in income inequality in advanced economies since the early 1980s.[2] And yet, fears of globalisation appear to dominate public discussion and are likely to have been a key factor in fomenting political opposition to the free movement of goods, services, capital, and people.

Much has been said about the perils of rising protectionism. Today, I would like to focus on a related but distinct risk, namely all the talk of a weakening of the international financial regulatory agreements that were reinforced in the wake of the financial crisis. Such a push-back would be all the more difficult to understand as there is compelling empirical evidence that excessive risk taking by the financial sector has contributed to rising inequality.[3] Dismantling regulatory standards would therefore not only make financial markets less safe, it would also be unfair to those who feel left behind.

Indeed, in recent years, through the actions of the Financial Stability Board (FSB) and standard-setting committees such as the Basel Committee on Banking Supervision, the international community has made important progress in rewriting the international financial rule book with a view to curbing financial exuberance, protecting taxpayers from costly bailouts, and improving cross-border cooperation.[4]

These reforms have undoubtedly made global financial markets more resilient. And they have also supported the recovery of loan growth to households and firms despite claims that regulation may hurt economic growth and dent bank profitability. Indeed, researchers at the Bank for International Settlements have found that soundly capitalised banks tend to lend more.[5]

Our experience in the euro area corroborates this view. The phasing in of new regulatory standards has helped bring about a measurable increase in euro banks' capital ratios in recent years. In parallel, and supported by the ECB's comprehensive monetary policy measures, bank loans to the real economy have recovered steadily from their cyclical (and historical) troughs and, towards the end of last year, were increasing at their fastest pace since the crisis.[6]

This suggests that a sound regulatory framework is an essential element of a country's growth agenda. But in an integrated global economy, financial regulation has to rely on internationally agreed standards. To the extent that countries around the world are signing up to these standards, the conditions for growth in a financially stable environment are being reinforced globally. Of course, this does not mean that we should not look back and evaluate critically what has been done already. The FSB, together with other bodies, will undertake a broad evaluation of the individual and combined effects of past reforms. It will assess if the initial objectives have been achieved or if there are any unintended consequences that call for changes to the regulatory framework. It will also assess whether reforms aimed at different industries or market segments have created conflicting incentives. And it will take stock of the progress achieved in curbing risk taking outside of the banking sector and in strengthening the resilience of financial market infrastructures.

But this exercise should not be mistaken for tolerance of hidden forms of financial protectionism or a relaxation of regulation. Turning back the clock on international financial regulation would revive distrust, create financial fragmentation, and risk regulatory arbitrage and a race to the bottom.

The stakes are too high to allow such short-termism to thrive. While unilateral financial deregulation may yield quick benefits, its potentially harmful implications for financial stability and, ultimately, economic growth are not likely to be felt until later. And then, those implications would be felt worldwide. Ultimately, this would leave the most vulnerable members of society very exposed.

More than ever, we Europeans are convinced that belonging to the European Union (EU) helps us maximise the benefits of international cooperation. It minimises the risks of short-sighted unilateralism. It offers a framework that disciplines Member States to work towards the common objectives and values enshrined in our treaties. It leverages the experience gained as one of the world's largest markets, which has existed for 60 years under a single rule of law. And it reminds us that there is no fair exchange without an agreed and enforceable set of rules, domestically and internationally.

Despite daunting challenges, the EU and the euro area in particular have a track record of overcoming common challenges through cooperation.[7] The creation of a single banking supervisor for the euro area, along with a single framework for bank recovery and resolution, is a recent case in point. It has created a level playing field for banks operating across the euro area that strengthens financial stability, eliminates double standards and can protect European taxpayers.

The European Commission's recent steps to curb illegal tax benefits for multinationals and to promote a common corporate tax base are another example. Progress on this front is essential as globalisation has made it more difficult to effectively tax multinational companies. Globalisation will be sustainable only if its benefits are spread across society. This is not something that market forces alone can correct. It is possible only if governments keep control of their tax and benefit systems. Effective tax cooperation can tilt the balance towards rebuilding trust in globalisation.

Strengthening these efforts is advisable. Globalisation has already helped to raise our living standards considerably. Over the past 25 years, world trade has increased by about twice as much as GDP, financial openness has quadrupled and millions of people, particularly in emerging and developing markets, have been lifted out of poverty. Regional and multilateral trade and financial agreements, alongside the creation of international financial and regulatory institutions and bodies, have significantly contributed to this process.

Many of us have taken these developments for granted. In Europe, for example, younger generations have grown up in the belief that the free movement of people, goods, services and capital is an unqualified right.

The current zeitgeist forces us to put aside our complacency. As the benefits and legitimacy of international cooperation are being called into question, it's essential to defend the values that underlie global economic governance – openness, collaboration and tolerance. Those who cherish the benefits of international cooperation should make their voices heard. They should highlight past achievements and explain why continued and strengthened cooperation is essential. This appeal must be seen as an opportunity and responsibility, not as a chore.

---

1 See, e.g., Solt, F. (2016), The Standardized World Income Inequality Database, Social Science Quarterly 97(5), 1267–81. In other advanced economies, e.g. France and Norway, net income inequality has remained fairly constant in recent decades.

2 See Dabla-Norris, E., K. Kochhar, N. Suphaphiphat, F. Ricka and E. Tsounta (2015), Causes and consequences of income inequality: A global perspective, International Monetary Fund Staff Discussion Note SDN/15/13, June.

3 See, e.g., Philippon, T., and A. Reshef (2012), Wages and Human Capital in the U.S. Finance Industry: 1909–2006, Quarterly Journal of Economics, 127(4): 1551–1607.

4 For a critical appraisal of the FSB, see Sheets, N. (2017), Race to the Top: The Case for the Financial Stability Board, Peterson Institute for International Economics, Policy Brief 17–12, April.

5 Gambacorta, L. and H. S. Shin (2016), Why bank capital matters for monetary policy, BIS Working Papers No 558, April 2016.

6 The common equity Tier 1 ratio of significant euro area banks reached 13.7% in the third quarter of 2016 against 9% in 2012. The annual growth rate of adjusted MFI loans to non-financial corporations (i.e. adjusted for loan sales, securitisation and notional cash pooling) stood at 2.0% in February 2017, up from a trough of –3.5% in February 2014. The annual growth rate of adjusted MFI loans to households stood at 2.3% in February 2017, up from a trough of –0.4% in November 2013.

7 See Cœuré, B. (2017), Sustainable Globalisation: Lessons from Europe, speech at a special public event “25 years after Maastricht: The future of Money and Finance in Europe”, Maastricht, 16 February.