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“The challenges of the multilateral economic order: What European responses?”

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Ladies and Gentlemen,

It is a pleasure to be in Tokyo this afternoon and to give this lecture at the Waseda University, in this splendid auditorium named after your illustrious founder, [Ōkuma Shigenobu]. The Waseda University is well known for the quality of its teaching and its founding principles – independence of learning, practical utilization of knowledge, education of good citizens – reflect the educational ambition of this place. I would like to warmly thank President Kaoru Kamata and Professor Kazumi Shimizu for their kind welcome speeches. Both of you lived in France and have maintained strong links with our country since then. It is thus no coincidence that the Waseda University under the Presidency of Mr Kamata is an active and remarkable example of the strong ties between Japan and France. It is therefore an appropriate place to talk about the challenges of the multilateral economic order, all the more so as Japan pays special attention to international cooperation. This issue can be considered on two levels: internationally and regionally. This afternoon, I will start by elaborating on the international level and the need for active multilateralism to face our global challenges. Then, I will dwell on the regional response. I will not elaborate on Asia, but on Europe, and the European Monetary and Economic Union.

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I. The need for active multilateralism to face our global challenges.

Let me start with my first point: the need for active multilateralism to face our global challenges. We have to strive to maintain the collective rules of the game, at international level and with all our partners. In the current context, international cooperation between countries is more important than ever: it is essential to preserving the improvement in the global economic environment. The global recovery has indeed been gathering pace since 2016: according to the latest IMF forecast, global growth should stand at 3.6% in 2017, after 3.2% in 2016, while in Japan real GDP growth should pick up to 1.5% in 2017 after 1.0% in 2016. Moreover, growth in the euro area should reach at least 2.2% this year, reflecting a strong economic recovery. However, there are two major risks threatening growth: financial instability and protectionism.

Regarding **financial instability**, the continued rise in global public and private debt since the start of the 2000s – from 190% of global GDP in 2001 to 230% in 2016 [slide] – has become a subject of concern. The 2008 crisis stemmed from this, but this trend has unfortunately not slowed down since; the private debt in emerging countries (namely corporate debt) has risen particularly rapidly. Since the G20 summits of London and Pittsburgh in 2009, **the regulatory**

effort that has been undertaken is unprecedented, in particular in the banking sector: by increasing both the quantity and quality of banking sector own funds, the Basel III reform has considerably enhanced the robustness of banks; in addition, it ensures better account is now taken of the diverse risks to which banks are exposed, thanks to the introduction of two new liquidity ratios for bank cash levels. I am confident that we are about to finalise a fair and reasonable agreement at our GHOS meeting next Thursday. This would be very welcome for our international financial order.

But beyond Basel III, we should finalise measures that target non-banks. We must ensure a balance between financing channels. The priority has now shifted **from the solvency of banks**, which has improved substantially, **to the liquidity of the shadow banking sector**, particularly funds and asset management companies that are exposed to the risks of sudden panic-driven runs. Moreover, we have to make sure that this internationally agreed regulatory framework is implemented everywhere with consistency. Unilateral deregulation would be nothing less than a lose-lose scenario with serious consequences for the stability of the global financial system – we would be paving the way for the next financial crisis – as well as the competitive landscape for US, Japanese and European banks.

The second risk is related to **protectionist tendencies,** namely in the United States. We, Europeans and Japanese, shoulder-to-shoulder with Canada and others elsewhere, must resolutely defend international economic relations based on commonly respected rules and multilateral institutions: their deterioration would dampen world trade and economic activity. In a recent speech, the Governor of the Bank of Japan, Haruhiko Kuroda, stressed “the importance of multilateral cooperation”. He said: “Economies must overcome their narrowly-defined self-interest so as to cooperate and coordinate from a broader perspective […]. It requires a well-functioning institutional framework such as the IMF, multilateral development banks (MDBs), and the G20.”[i] These words are particularly relevant in the current context.

II. Regional responses: the case of Europe

Let me now turn to my second point: regional responses, taking Europe as the example. The European Union is a unique case of very advanced cooperation between countries at a regional level. The cooperation is obviously multifaceted, but today I would like to focus on three shared economic and social assets of Europe: its single currency, its single market, and its unique social model.

Three European assets: its single currency, its single market, and its unique social model.

First, with **the euro**, we share **a solid currency** which is recognised worldwide. Let me say it straight away: the Monetary Union can be considered as one of Europe's greatest successes. As you know, the single currency was officially launched with the Maastricht Treaty in 1992 and introduced in 1999. But 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. The euro has indeed provided us with a strong symbol of unity among European nations. It is true that there is currently some euro-scepticism and a surge of populism, but, a clear majority of euro area citizens support the euro today (73% according to the latest Eurobarometer)[ii] [slide]. From 12 at the start, the number of participating countries has risen to 19 today. Seven additional countries have decided to join the euro since 1999 –most recently Lithuania in 2015 –, and none has wanted to leave it. 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.

The fact is the euro has already delivered material benefits. In line with our mandate, inflation has been kept under control. This directly benefits household purchasing power and helps build confidence in the value of the currency. Let us take a historical perspective. In the 18 years preceding the introduction of the euro (1981-1998), inflation gradually declined but remained at 4.6% on average, with major disparities across countries. In the 18 years since the euro (1999-2016), inflation has been much more stable, averaging 1.7% [slide], and the disparities across countries have narrowed. Besides, better controlled inflation means lower financing costs, because it reduces risk premia [slide]. All economic players benefit from lower interest rates: households, when they purchase a property, companies when they invest, but also governments and hence taxpayers. In addition, the euro has helped consolidate the European single market, by eliminating currency fluctuations for corporates, simplifying day-to-day life for citizens and promoting capital market integration.

Lastly, the economic size of the euro area and the stability of its currency have enabled the euro to play an important international role. Today, the euro accounts for 20% of international reserves, second only to the US dollar. An internationally recognised currency generates economic gains: financial markets are more attractive to domestic and foreign investors, more liquid, and thus more efficient. But it also carries a political weight: when Mario Draghi speaks at the G7 or G20, the whole world listens to Europe attentively, just as when Janet Yellen speaks for the United States.

Overall, this list of benefits is impressive, particularly when you think that the euro is only 19 years old. More importantly, we have come this far despite the global financial crisis, which triggered the deepest recession in three generations and despite the euro area sovereign debt crisis a few years later. The robust economic recovery in the euro-area now enables us to pursue a path of gradual normalisation of our monetary policy. On 26 October, the Governing Council of the ECB, dividing in half the volume of our monthly net asset purchases, took a decisive step towards possibly ending them, while maintaining with all our other instruments an ample degree of monetary accommodation.

Second, we in Europe share a large **single market**. It removes all internal borders and regulatory obstacles to the free movement of goods, capital, services, and persons in the European Union. It is a tremendous asset which belongs to us all – the 27 – and it is no coincidence that access to the single market lies at the heart of the Brexit debate. We cannot foresee the outcome of the future negotiations and we don't want to "punish" the United Kingdom in any measure. But we must respect one consistency principle: access to the single market must continue to go hand-in-hand with strict acceptance of all its rules. There can be no cherry-picking or free-riding. For the financial services industry, this means that you can hardly expect to obtain a European passport if you do not accept the single market's rules.

Third, we share a common **social model** which combines high standards of public service, relatively low levels of inequality – much lower than in American society – and a good intensity of social dialogue. And this has been achieved in a market economy. At a time when globalisation may leave many behind in advanced economies, when the debate about inequalities is coming back to the forefront – and these are real challenges behind the populist wave –, now is not the moment to give up our social model. Europe and Japan are quite close in their choices.

How to move forward: four accelerators of the Economic Union.

The assets that I have presented constitute a valuable achievement for Europe. Now, we must actively build on them, and not lazily rest on our laurels. I will now present some avenues of improvement. Indeed, we have clearly succeeded in building a Monetary Union, but this is not sufficient. It is now time to make concrete progress on Economic Union, on which we have not been very effective yet. We are in agreement on the "**why**". Monetary policy cannot be the only game in town, and therefore we should not overburden it. Furthermore we aim at greater **stability**, to counter the risk of a new crisis befalling an unprotected euro area, with all its damaging political and economic repercussions; and greater **growth**, to catch up our past lag on the United States and finally treat the fatal disease of mass unemployment in Europe. As for the **"when"**, we obviously have a unique historic opportunity: with the economic recovery; with the new French President and also stable governments in the Netherlands and hopefully in Germany.

With this objective in mind, **how,** concretely, can we make progress on Economic Union? There is an absolute prerequisite: the implementation of national reforms. Let me say, as an independent central banker, that the new French government, under Mr. Macron's presidency, has already made decisive steps in that direction [slide]. A substantial labour market reform was approved last summer and has already been implemented. A forthcoming reform of vocational training and apprenticeship is expected next year. Moreover, measures have been taken to keep public deficits below the threshold of 3% of GDP. For the first time in 10 years, the government deficit should be below this threshold in 2017 (2.9%). Needless to say, these efforts have to be pursued in the future. Furthermore, in my view, we should also trigger four accelerators [slide]:

- **A macro accelerator**: a collective economic strategy in the euro area. It is premised on one simple fact: economic growth and employment would be stronger in the euro area if we combined more reforms in countries where they are needed, like France or Italy, and more stimulus in countries with leeway for it, like Germany or the Netherlands. To achieve this collective economic strategy, euro area Member States have to seal a deal, which could be prepared and adopted as early as 2018. It could be supplemented by the creation of a Stabilisation Lending Instrument, aimed at supporting, through credits, Member States facing asymmetric shocks. This could be part of a European Monetary Fund, provided that its scope of action is extended beyond the current European Stability Mechanism.

- **A micro accelerator**: i.e. a Financing Union for Investment and Innovation. The aim is to mobilise the EUR 350 billion savings surplus of the euro area, notably to shore up equity which is the key to an innovation economy, and also to foster synergies, thanks to an integrated steering mechanism, between the Juncker investment Plan, the Capital Markets Union and Banking Union.

- **A fiscal accelerator**, once we have increased trust between Member States and made headway towards greater economic convergence: the euro area budget could be used to finance, for the benefit of all countries, certain "European common goods" such as digital technology, energy transition, security, and migration controls.

- **An institutional accelerator**: The fourth is not an accelerator in substance, but rather a "facilitator" for the first three. In terms of institutions, we would need first and foremost a euro area Finance Minister, President of the Eurogroup and member of the Commission, backed by a European Treasury; but also a euro area Parliament group, in order to ensure the democratic legitimacy of the institutions and decisions. But it only makes sense if we make progress on the substance: if not, it would be little more than mere window dressing.

The latter two accelerators, fiscal and institutional, would require Treaty changes, unless they were to be very limited. But this must not stop us from making progress straightway on the first two accelerators, in order to breathe new life into the Economic Union. These accelerators would contribute to the functions of economic policy, as described by Musgrave:[iii] allocation, stabilisation and distribution. The allocation function would obviously be the role of the micro accelerator, but also of the fiscal one. The stabilisation function could be ensured mainly by the macro accelerator, but also by the micro one, thanks to enhanced private risk sharing, and possibly by the fiscal one. Finally, a distribution function – if any – could possibly fall to the fiscal accelerator provided that its implementation does not result in a "transfer union" which would be a one-way budget.

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I would like to conclude my speech by quoting Kazuo Ishiguro, who was awarded the Nobel Prize in Literature for 2017 and who was born in Japan: "If you are under the impression you have already […] perfected yourself, you will never rise to the heights you are no doubt capable of."[iv] These words could apply to our international cooperation since the crisis, as well as to the European Economic and Monetary Union. Both are undeniable successes and it is well worth emphasising it. But this should not prevent us from making progress towards a better functioning of the Economic Union. I strongly believe that we could achieve something that even today may still be considered unbelievable. Thank you for your attention.

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[i] "The Global Economy and the Global Financial System: In an Era of Revival and Metamorphosis", Speech at the Institute of International Finance (IIF) Spring Membership Meeting, Haruhiko Kuroda, Governor of the Bank of Japan, 9 May 2017.
[ii] European Commission, Standard Eurobarometer 87, Spring 2017.
[iii] Musgrave (R.) and Musgrave (P.), *Public Finance in Theory and Practice*, McGraw Hill, 1989.
[iv] Kazuo Ishiguro, *The Remains of the Day*, 1989.