François Villeroy de Galhau: New ideas for Europe

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France, Munich, 15 February 2018.

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Mr. Prime Minister,

Ministers,

Dr. Theo Waigel,

Ladies and Gentlemen,

It is an honour for me to speak here this evening, following on from my compatriot from the Saarland, the Finance Minister, Peter Altmaier. I am 100% French, but with family roots in Germany that go back two centuries... and Dr. Altmaier even represents my town of Saarlouis in the Bundestag. However, all honour today goes to Munich and to Bavaria, and I would like to thank Dr. Theo Waigel for so kindly inviting me. Dr. Waigel, you played a key role in the construction of our European currency. I would like to repeat the words that you used before the Bundestag in April 1998 in anticipation of the transition to the third phase of our Economic and Monetary Union: "After two devastating and painful world wars, the European project is opening up opportunities to our children and grandchildren that our mothers and fathers, our ancestors, would never have dared dream of".[1] Twenty years later, we can state that monetary union is a success: 74% of euro area citizens support the euro, and this figure is as high as 81% in Germany. The Economic Union on the other hand, has not yet fulfilled its potential. And that is a concern for two reasons. First, because even though the current economic cycle is in a very robust phase today, it will come to an end at some point. If we have not armed ourselves with stronger economic instruments by that time, there is a risk that monetary policy will be overburdened. This is a well-founded German worry that as a central banker I share entirely; but it is for that very reason that I say to our German friends that they must aspire to an enhanced economic union. Second, because the absence of a genuine economic union is holding the euro area back, at a time when we must stimulate growth to catch up our past lag, particularly vis-à-vis the United States, and address the radical technological transformation. The theme of this evening is "new ideas for Europe". But to have new ideas, we must begin by putting the old clichés that are paralysing the debate behind us. That is what I will begin by doing, before setting out my three new ideas for Europe.

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1. Three old clichés that we must put behind us

The first old cliché that emerges when we speak about reforming the euro area, is the idea – and a lazy idea at that – that **economic union would be a substitute for national reforms.** I would like to repeat right away that on the contrary, national reforms are a prerequisite for any enhancement of the Economic Union, and today, France is well aware of this. I say this in my capacity as a totally independent central banker: the new government in France is taking reforms very seriously and is acting with impressive speed. France is now a reliable economic partner of Europe and Germany.

Second, it would be ridiculous to reduce the debate to the old caricature that contrasts **"German rules" with "French expenditure"**. To my mind, it is out of the question to implement a "transfer union", which would only benefit certain countries, or to introduce Eurobonds, which would amount to collectivising debts. Need I remind that France too is a net contributor to the European budget, or to financing for Greece? But I am convinced that risk sharing between countries can – and should – go hand-in-hand with risk reduction mechanisms. It is wrong to draw a distinction between solidarity and responsibility: in reality, they are complementary. For crisis prevention to be credible, it must also have the instruments needed to cushion the effects of substantial shocks that may arise regardless.

As for the third cliché, let's stop pitting the **"French vision" against "German pragmatism"**. In order to reform the euro area, we must be practical and take real needs, and particularly those of businesses and entrepreneurs, as our starting point – as I aim to do in the second part of my speech. In 1978, Helmut Schmidt said that "the citizens of Europe just want solutions to concrete issues".[2] Nonetheless, we need a political ambition if we are to act – call it a "vision", if you wish. We need this because we have to make progress – it's now or never: thanks to the economic recovery, and thanks to President Macron's initial proposals at the Sorbonne, and the European chapter of the German coalition agreement – it is obviously not my place to comment on the rest of the agreement – we are enjoying historically favourable conditions. If we don't act in 2018 – first the French and Germans, and then all 19 member countries of the euro area – we will never make headway.

2. How to strengthen the euro area: three new ideas

I will now turn to my three new ideas to strengthen the euro area. In order to make genuine progress in Europe, we must first start with the **real needs for corporate investment, and the resources at our disposal**. In terms of needs, the key to growth in the euro area today is, without doubt, innovation. Chancellor Merkel spoke about it in Davos three weeks ago, while companies in Bavaria are well placed to recognise its importance: over the past 50 years, Bavaria has radically transformed its economy by rising to the challenge of innovation. But to innovate, in digital technology, or in energy transition for example, companies need to be able to take more risks, which requires more equity financing, over the long term, rather than debt financing. The euro area is seriously lagging behind in this respect: equity capital amounted to only 73% of GDP in 2017, compared with 123% in the United States. As for resources, let's take what is often a difficult debate – on Germany's substantial surpluses – and transform it into a positive: we have abundant savings in the euro area. In order to match resources to needs, I propose a European-level "**Financing Union for Investment and Innovation**", which would better channel the EUR 350 billion savings surplus into equity financing and innovation, in digital or energy technologies. This Union should bring together existing initiatives, and as a priority, the Capital Markets Union, but also the Banking Union and the Juncker Investment Plan. The Capital Markets Union requires concrete progress on several fronts: amending accounting rules, taxes and insolvency laws to facilitate cross-border investment, notably in equity capital; and developing pan-European long-term savings products. Within the Governing Council, and together with my colleague Jens Weidmann, President of the Bundesbank, we find it most regrettable that the Capital Markets Union is currently being overlooked in political discussions on enhancing the euro area.

My second idea to make progress in Europe is to start with the **quality of public spending** and give priority to investment and expenditure for the future. Until now, we have mainly been concerned with "quantities", and I would just like to say a word in this respect on the Stability and Growth Pact: in my mind, it would be both dangerous and illusory to want to change the rules – rather, let's respect them. But at the same time, we should consider the quality of public spending: in order to boost potential growth, in the long term, expenditure on investment and on our future are vital, including on education and training and, of course, new technologies. This is true of national budgets, but we could amplify the effect through a euro area investment budget. This budget could be used to finance, for the benefit of all countries, certain "common goods" such as digital technology, energy transition, security, and external border protection.

Finally, my third idea begins with a question: how to deal with **stabilisation**? In other words, how to deal with the shocks that can have a brutal effect on certain national economies? Private risk sharing through the Capital Markets Union and the Financing Union that I mentioned earlier, is part of the answer. In the United States for example, the stock market is capable of absorbing around 40% of a State-specific shock. But that is not enough and it is absolutely vital that we go further still. Otherwise monetary policy may bear too much of the burden during a future recession, which would be dangerous – monetary policy should not be the only game in town. In the euro area, we therefore need better economic policy coordination. Countries will continue to be responsible for their economic policies, but we can aim for a better collective economic strategy with more reforms in countries where they are needed and with more fiscal or wage support in countries with room for manoeuvre. This collective strategy could be supplemented by enhancing the European Stability Mechanism to transform it into a European Monetary Fund; this would require that the scope of its actions be expanded to include a genuine crisis prevention role and that its governance be amended. Otherwise, it would be a simple change of window dressing.

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To conclude, I would like to mention another reason why 2018 must be Europe's year: our international environment, with the prospect of Brexit and the presidency of Mr. Trump in the United States. Confronted with the challenges of globalisation, Europe's twofold message is essential. First, our common social model – *die Soziale Marktwirtschaft* – combines a high level of public service, relatively low levels of inequality and a strong intensity of social dialogue; it is the ideal response to the debate on inequality, which is returning to the forefront. Second, our commitment to multilateralism is vital to confronting the temptations of protectionism. We must resolutely defend, alongside Canada and certain Asian partners, the commonly respected rules and multilateral institutions. Today's world needs a stronger Europe. And so it's time that we, Europeans, took our destiny into our own hands.

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1 Address given by Theo Waigel on the third stage of Economic and Monetary Union, 23 April 1998.

2 Speech by Helmut Schmidt on the outcomes of the Brussels European Council, 21 December 1978.