Mario Draghi: Farewell remarks

Remarks by Mr Mario Draghi, President of the European Central Bank, at the farewell event in his honour, Frankfurt am Main, 28 October 2019.

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This year marks two decades of monetary union, which is by any measure a momentous anniversary. Not so long ago, the euro area economy was scarred by a level of unemployment probably unseen since the Great Depression, and fundamental questions were being asked about whether the euro would survive. Today 11 million more people are in work. Public trust in the euro has risen to its highest level ever. Across the euro area, policymakers are reaffirming that the euro is irreversible.

But I see today more as an occasion to reflect than to celebrate.

The euro is an eminently political project, a fundamental step towards the goal of greater political integration, which found its economic justification in the parlous state of European economies in the mid-1980s. Unemployment had risen from 2.6% in 1973 to 9.2% in 1985 and growth had slowed significantly in the 12 countries that would go on to form the euro area.

What the visionary leaders of that era saw, however, was that Europe had a powerful tool at its disposal to raise growth: to transform its common market into a single market. Removing existing barriers to trade and investment could reverse the decline in economic potential and bring more people back into work.

Yet the Single Market was always about more than just this. It also aimed to protect people from some of the costs of the changes that would inevitably arise. Unlike the wider process of globalisation, it allowed Europe to impose its values on economic integration – to build a market that, to the extent possible, was free and just. Common rules would create trust between countries, give the weak recourse against the strong and provide safeguards for workers.

The Single Market, in this sense, was a bold attempt at "managed globalisation". It combined competition with levels of consumer and social protection unseen in the rest of the world.

But there was one type of unfair practice that the Single Market could not prohibit: competitive devaluations. That prospect would undermine the mutual trust that was critical for the Single Market to survive and for the project of greater political integration to progress.

Freely floating currencies were therefore not an option, and fixed exchange rates would not work as capital became more mobile within Europe, as the ERM crisis in 1992–3 proved.

The answer was to create a single currency: one market with one money.

This construct has been largely successful: incomes across the continent have materially increased, integration and value chains have developed to an extent unimaginable 20 years ago, and the Single Market has survived intact through the worst crisis since the 1930s.[1]

But the past 20 years have taught us two vital lessons for a successful monetary union.

The first concerns monetary policy.

When the ECB was established, its dominant concern was to keep inflation down. The ECB was a new central bank with no track record, so its policy framework was expressly designed to build strong anti-inflationary credibility. It achieved this quickly, and it is to the tremendous credit of the ECB's early leaders that its first decade went so smoothly.

But no one could have foreseen that the environment facing monetary policy globally was soon to abruptly reverse: that inflationary forces would turn into deflationary ones.

In all advanced economies, this called for a new paradigm for central banking, which comprised two elements: the determination to fight deflation as strongly as inflation, and flexibility in the choice of instruments to do so.

In our case, the ECB has proven that it will not accept threats to monetary stability caused by unfounded fears about the future of the euro. It has shown that it will fight risks to price stability on the downside as vigorously as those on the upside. And it has established that it will use all the tools within its mandate to secure its mandate – without ever exceeding the limits of the law.

The European Court of Justice has affirmed the legality of the measures we have taken, and it has confirmed the ECB's broad discretion in using all its instruments in a necessary and proportionate way to achieve its objective.

This judgement was crucial, because at stake was the essence of the central bank that the ECB has become, and that most people in Europe want to see: a modern central bank able to deploy all its instruments commensurate with the challenges it faces, and a truly federal institution that acts in the interests of the whole euro area.[2]

The second lesson concerns the institutional construction of EMU.

The euro area is built on the principle of "monetary dominance", which requires monetary policy to be single-minded in its focus on price stability and never to be subordinate to fiscal policy. "Monetary dominance" does not preclude communicating with governments when it is clear that mutually aligned policies would deliver a faster return to price stability. It means that alignment between policies, where needed, must serve the objective of monetary stability and should not work to the detriment of it.[3]

Today, we are in a situation where low interest rates are not delivering the same degree of stimulus as in the past, because the rate of return on investment in the economy has fallen. Monetary policy can still achieve its objective, but it can do so faster and with fewer side effects if fiscal policies are aligned with it.

This is why, since 2014, the ECB has gradually placed more emphasis on the macroeconomic policy mix in the euro area.[4] A more active fiscal policy in the euro area would make it possible to adjust our policies more quickly and lead to higher interest rates.

In our monetary union, national policies play the main role in fiscal stabilisation – much more so than state-level policies in the US. But national policies cannot always guarantee the right fiscal stance for the euro area as a whole. Coordinating decentralised fiscal policies is inherently complex. And uncoordinated policies are not enough, because the spillovers between countries from fiscal expansions are relatively low.

This is why we need a euro area fiscal capacity of adequate size and design: large enough to stabilise the monetary union, but designed not to create excessive moral hazard.

There will be no perfect solution. When risks are shared, moral hazard can never be reduced to zero, though it can be greatly contained by proper design. At the same time, we should also recognise that sharing risks can help reduce risks.

The building of a capital markets union, which would lead to greater risk-sharing in the private sector, would considerably reduce the fraction of risks that need to be managed by a central fiscal capacity. And a central fiscal capacity would in turn reduce risks for the whole union when national policies are unable to play their role.

In other regions where fiscal policy has played a greater role since the crisis, we have seen that the recovery began sooner and the return to price stability has been faster. The US had a deficit of 3.6% on average from 2009 to 2018, while the euro area had a surplus of 0.5%.[5]

In other words, the US has had both a capital markets union and a counter-cyclical fiscal policy. The euro area had no capital markets union and a pro-cyclical fiscal policy.

The road towards a fiscal capacity will most likely be a long one. History shows that budgets have rarely been created for the general purpose of stabilisation, but rather to deliver specific goals in the public interest. In the US, it was the need to overcome the Great Depression that led to the expansion of the federal budget in the 1930s. Perhaps, for Europe, it will require an urgent cause such as mitigating climate change to bring about such collective focus.

Whichever path is taken, it is plain to see that now is the time for more Europe, not less. I mean this not in an axiomatic way, but in the truest traditions of federalism. Where results can best be delivered by national policies, let it stay that way. But where we can only deliver on the legitimate concerns of the public by working together, we need Europe to be stronger.

For us Europeans, in a globalised world, a true sovereignty that meets people's needs for security and prosperity can be achieved only by working together.[6] As Chancellor Merkel has said, "we Europeans have to take our destiny into our own hands if we want to survive as a community".[7]

Working together allows us to protect our interests in the world economy, to resist the pressures of foreign powers, to influence global rules to reflect our standards, and to enforce our values on global corporations. None of these can be achieved to the same degree by countries acting alone. In a globalised world, sharing sovereignty is a way to regain sovereignty.

But recognising that we need to exercise what President Macron has termed "European sovereignty"[8] to be effective does not mean that we already have the political infrastructures to do so today. Awareness of their necessity is growing quickly, however.

We saw this emerging in the most recent European Parliament election, which was perhaps the first such election fought mainly on European questions. Even those who were seeking to slow down European integration did so by contesting the EU institutions rather than rejecting their legitimacy outright.

This is only a start, but it suggests our union is moving in the right direction. I am confident that it will continue to do so, because it is ultimately the self-interest of individual countries that lays out our future path towards a European sovereign.

The actions of many committed Europeans, at both the national and EU levels, have helped us to reach this point. There are three groups whose contributions I would like to single out.

The first is the staff of the ECB and the national central banks.

There were many occasions during the crisis where the ECB found itself in truly uncharted waters. We faced, by any measure, an incredibly complex economic situation, with new challenges appearing the moment old ones were resolved.

Those years were intense for you and your families. But your dedication, the success of the measures you designed, and the competence you displayed across the Eurosystem in implementing those measures, will make those years worth remembering.

These policies are now available to all future policymakers to meet similar challenges. This is a legacy of which all Eurosystem staff can be proud. So, let me express my gratitude for all your remarkable efforts, which have truly served the ECB through this unprecedented time, and in doing so the people of Europe.

The second group I would like to highlight are my colleagues on the Executive Board and Governing Council – both past and present. You have enacted a series of measures over the past eight years in extraordinary circumstances. The bedrock of those decisions has been your consistent and unconditional commitment to our mandate.

You have been unwavering in your determination both to deliver our mandate and to stay within its confines – to never accept failure. You can look back with satisfaction on what you achieved in extremely testing conditions, and in the knowledge that you have improved the welfare of many people.

What unites the Governing Council has always been – and will always be – much greater than anything that might divide it. We all share the same devotion to our mandate and the same passion for Europe. I trust that this shared conviction will continue to serve the ECB and Europe in the years to come.

The third group is Europe's leaders.

We had to take measures that sometimes appeared controversial at first and whose benefits were only revealed slowly. Our determination never wavered as it was founded on the solid work of our staff, nourished by empathy for the people who were suffering, and strengthened by the conviction that the policies would improve their situation.

But in such times – and especially in a multi-country currency union – political leaders who transcended national perspectives when assessing our monetary policy, and who acknowledged the euro area perspective and explained it to their domestic audience, provided an essential bulwark for our independence.

I am grateful that we have had such leaders in Europe, and for your steadfast support and encouragement throughout the crisis.

President Macron, President Mattarella, Chancellor Merkel: you have stood beside us unfailingly in the European Council and in global forums, at a time when other major central banks have faced increasingly vocal political pressure. You have pushed back strongly against illiberal voices that would see us turn our back on European integration.

And, at critical moments, you have taken the steps needed to safeguard the euro and protect the heritage that was left to us: a united, peaceful and prosperous Europe.

The time has come for me to hand over to Christine Lagarde. I have every confidence that you will be a superb leader of the ECB.

My goal has always been to comply with the mandate enshrined in the Treaty, pursued in total independence, and carried out through an institution that has developed into a modern central bank capable of managing any challenge.

It has been a privilege and an honour to have the opportunity to do so.

Thank you.

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1 See speech by Mario Draghi entitled "Europe and the euro 20 years on" on accepting the Laurea Honoris Causa in economics from the University of Sant'Anna, Pisa, 15 December 2018.

2 See speech by Mario Draghi entitled "Twenty Years of the ECB's monetary policy" at the ECB Forum on Central Banking, Sintra, 18 June 2019.

[3] Speech by Mario Draghi entitled “Policymaking, responsibility and uncertainty” on accepting the Laurea Honoris Causa from the Università Cattolica, 11 October 2019.

[4] See speech by Mario Draghi entitled “Unemployment in the euro area” at the Annual central bank symposium in Jackson Hole, 22 August 2014.

[5] Average cyclically adjusted primary balance as a percentage of potential GDP.

[6] See speech by Mario Draghi entitled “Sovereignty in a globalised world”, on accepting the Laurea Honoris Causa in law from Università degli Studi di Bologna, Bologna, 22 February 2019.

[7] Speech by Chancellor Angela Merkel to the European Parliament, Strasbourg, 13 November 2018.

[8] Speech by President Emmanuel Macron to the European Parliament, Strasbourg, 17 April 2018.