Carlos da Silva Costa: The euro 20 years on - the debut, the present and the aspirations for the future

Opening address by Mr Carlos da Silva Costa, Governor of the Bank of Portugal, at the Bank of Portugal Conference: "The euro 20 years on: the debut, the present and the aspirations for the future", Lisbon, 15 November 2019.

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It is with great pleasure that I welcome you to this Conference that marks the **first 20 years** of the euro. Now is an opportune moment **to take stock** of these two decades and **to reflect upon the lessons we have learned** and on **how they should shape our response to the challenges ahead**. The start of a n**ew EU institutional cycle** also adds importance to this reflection.

I totally concur with Mario Draghi when he said, in January, at the European Parliament, that ***"The euro is the most tangible representation of European integration that our citizens encounter, on a daily basis"***[1]. Indeed, the euro is the most visible face of the collective will of 19 Member States that have decided to share a common destiny and who believe that **together they are stronger**. Other Member States are expected to join them in this joint endeavour very soon.

The European Economic and Monetary Union (EMU) is a **unique case of monetary integration** and its construction has never been easy or consensual. From the outset, the EMU was criticised, and **several voices** – especially from the other side of the Atlantic – **predicted a short life for the euro**.

I would say that **the birth of the European single currency project was accompanied by "two fairy godmothers" with negative omens for its future**:

1. **The theory of optimal currency areas**[2](OCA), including the criteria deemed necessary for a region to qualify as an OCA and benefit from a common currency;
2. The idea that **without effective federal power there could be no successful single currency**.

Twenty years later, and contrary to the views of the prophets of doom – which recently seem to have become very active again – **the euro is here to stay. It has become stronger over the years, and popular support is currently at historic highs**[3]. The single currency functions like a **common language**: it brings people closer in many ways and creates a social bond and a common identity[4].

The **euro's resilience** shows that its **main foundations are sound** and that **its founding fathers were steering the European project in the right direction. The euro is not the result of a single political decision. It is the result of successive political decisions and the evolution of the European integration process**.

The euro is a logical and necessary consequence of the single market. Currency fluctuations – even when resulting from the normal functioning of the markets – translate into subsidies/penalties for economic agents and create uncertainty. They distort competition, generate trade reallocations not based on economic fundamentals and cause social discontent.

It was evident that the **Exchange Rate Mechanism of the European Monetary System was not compatible with the degree of openness** of the economies participating in the single market **and the existence of autonomous monetary policies**.

It was this inconsistency that led to **the 1992–1993 currency crisis**, which **clearly showed in practice that an internal market without a single currency is necessarily an unstable equilibrium**. The euro has safeguarded the **integrity of the single market and has delivered two decades of price stability**.

The euro has fostered **confidence** and brought **important and tangible benefits** to European households, businesses and governments. Naturally, it has also introduced **new requirements** with regard to the behaviour of economic agents as **well as new rules and institutions**. It made the **need for adequate policies, sound public finances and financial discipline of private actors more visible**.

A single currency implies a single monetary policy and, in a context of markedly heterogeneous national revealed preferences, there is a risk of inconsistency between national economic and fiscal policies and the common monetary policy. It was therefore clear from the outset of EMU that it would be **necessary to create discipline, rules and institutions that would reduce disparity in order to ensure stability**.

The EMU rests on **a comprehensive set of rules** and on a **non-federal institutional framework** based on a **sharing of sovereignty** between Member States and, above all, on **mutual trust**. This means that its success hinges on its members making every effort to understand each other and to mutually realise their interests. In a nutshell, the euro is **the result of a dialectic process between solidarity and responsibility towards a common good**.

The functioning of EMU is based on **permanent negotiation and approximation of different starting positions**, safeguarding national cultures and identities while guaranteeing a sense of belonging and a “group identity”. This implies **an institutional framework with a great capacity to understand and manage differences** and to facilitate the interaction between the interests of the whole and the specificities of the parts. The principles of **collective ownership** and **consensus** must always be kept in mind.

The European regulatory framework and the architecture of the EMU have significantly evolved and consolidated over the years, notably in response to the sovereign debt crisis in the wake of the global financial crisis.

In fact, the sovereign debt crisis in the euro area brought to the forefront **the weaknesses of the EMU framework**, exposing the **particular vulnerability of euro area Member States to changes in markets’ sovereign risk perceptions**. The link between the financial system and the sovereign was absent from the Maastricht context and **the “no bailout” clause** meant that no Member State could expect the Union to bail it out, while respecting the monetary financing prohibition.

To face the huge challenges posed by the crisis it became clear that decisive and urgent action had to be taken to ensure **stronger economic governance, better coordination of Member States’ policies and a sounder financial sector**.

Far-reaching improvements were introduced into the regulatory and institutional framework, the economic coordination and surveillance procedures (e.g. the European Semester and the Macroeconomic Imbalance Procedure) **and the European financial sector**, which underwent a remarkable transformation.

Since the outset of the crisis, the ECB has played a crucial role and helped saving the euro. With its **unconventional policies, it allowed the time for political agents to adjust their fiscal**

policies, to adopt structural measures and to agree on regulatory and institutional improvements needed for a sustainable EMU.

In the euro area, **the Banking Union was launched. Its initial design envisaged a Single Supervisory Mechanism** (SSM), **a Single Resolution Mechanism** (SRM) and **a common deposit guarantee scheme** underpinned by a single rulebook. The SSM and the SRM have been successfully implemented. However, **the political will to complete the Banking Union's architecture has waned in recent years** with policy-makers focusing excessively on the risk reduction versus risk sharing debate. **The fact that some critical elements of the Banking Union are still missing undermines its fundamental benefits**.

While we must not underestimate the remarkable progress that has been achieved in recent years, we should acknowledge that **Europe's financial architecture still needs to be further strengthened to withstand the impact of a possible future crisis**. This must be a priority for policy-makers and relevant institutions because **not many things can be more destructive to public trust in European institutions than threats to financial stability**. In particular, **decisive political will to move forward with the completion of the Banking Union and the development of the Capital Markets Union is much required**.

Furthermore, in this still incomplete EMU, the **interaction between monetary and fiscal policies, their roles and limitations for macroeconomic stabilisation** and the **adequacy of the current Stability and Growth Pact** are ever more at the forefront of the policy debate. All these issues need to be addressed.

I have already underlined the importance of a coherent and sound legal and institutional framework. We must, however, be aware that, **even with appropriate rules and institutions, a monetary union is not immune to exogenous shocks and specific problems in any of its members**.

The EMU needs stabilisation mechanisms to support Member States facing serious financial difficulties while safeguarding the stability and cohesion of the group. This need is **one of the major lessons of the financial crisis** and the reason for the creation in 2010 of a temporary rescue fund, the **European Financial Stability Facility** (EFSF), and subsequently, in 2012, of a permanent institution, the **European Stability Mechanism** (ESM).

Both the EFSF and the ESM have played a vital role in safeguarding the stability of the euro area as a whole, functioning as a common firewall and providing support to the most affected Member States to resume or maintain access to sovereign bond markets. Together with fiscal and structural reforms at European and national levels, the ECB's unconventional monetary policy and the establishment of the Banking Union, **these funds were instrumental in dealing with the worst of the crisis and to save the integrity of the euro**.

Reform of the ESM is on-going to reinforce its role, its operational capacity and the effectiveness of its instruments. This reform must be seen as an integral part of the agenda on deepening EMU and needs to be ambitious.

I have always argued that the ESM should evolve towards a true European Monetary Fund, a robust crisis management body, incorporated into EU law. An independent and accountable institution with a clear mandate and adequate resources and firepower. These are necessary conditions for the development of win-win solutions. The work currently underway on the ESM Treaty should therefore not be seen as the final result, but as a step towards a more ambitious long-term goal.

Let me conclude.

During its first 20 years of life – and contrary to the initial bad omens – **the euro's institutional framework has proven its ability to overcome the difficulties stemming from the coexistence of economies in different stages of development**, and sovereignty-sharing mechanisms have acted as a proxy for a central political power.

Today's conference calls upon us to assess these first two decades of the euro as well as to reflect on its future:

1. Which are the main challenges ahead?
2. How should EMU evolve?
3. What should we aspire for the future role of euro at the global level?

These are very important questions, which we must all reflect upon in order to contribute to **further strengthening the European project, bearing in mind the profound and rapid changes, at all levels, that have been taking place in the world** in the last few years.

In the current **globalised, competitive, digitalised and interlinked environment**, there is an **increased need for euro area countries to work together to exercise sovereignty and make their voices heard**. We should always bear in mind that **sharing sovereignty is not a synonym of loss of control or power**. Internal cohesion and "teamwork" will help **protect Member States from external pressures and spillover effects, and empower their policy choices**.

Member States must therefore **persist in working together in a committed way to continue the journey that started in 1999**, so that European citizens can fully reap the benefits of their common currency. **Cooperation within EMU will also support an increased role of Europe and the euro in the world**.

I am sure that today's discussion **will be very fruitful and will bring new, good ideas** to help equipping the euro area with the tools it needs to withstand headwinds and to prosper.

Quoting Robert Schuman: ***"Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity"***. And it goes without saying that solidarity must go hand-in-hand with responsibility, which entails rules and mutual surveillance institutional mechanisms.

Before giving the floor to Jean-Claude Trichet, **I consider it both an honour and a duty to underline the important role he has played at several stages during the EMU creation and consolidation process**, notably in the pre-Maastricht political negotiations and as President of the ECB.

Dear Jean-Claude, the floor is yours.

Thank you.

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[1] Speech by Mario Draghi, President of the European Central Bank, at the session of the plenary of the European Parliament to mark the anniversary of the euro in Strasbourg, 15 January 2019.

[2] For a survey of literature on OCA theory see Dellas, H. and Tavlas, G.S. (2009), "An optimum-currency-area odyssey", Journal of International Money and Mongelli, F.P. (2002), "'New' views on the optimum currency area theory: what is EMU telling us?", Working Paper Series, No 138, ECB Finance, Vol. 28 (7).

[3] European Commission (2019), Standard Eurobarometer 91 – Spring 2019.

[4] Otero-Iglesias, Miguel (2017), "*The euro as a social bond: why do Eurozone citizens still back the single*

currency?" Real Instituto Elcano, 25/IV/2017.