"The future of European integration" - speech at European Financial Congress

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(*Please check against delivery*)

Ladies and gentlemen,

It is an honour for me to speak to so many of you about European integration. Poland is the right place for this topic. Your country played a historic role in bringing down the Iron Curtain. Pope John Paul II was a leading actor in uniting our divided continent. For this, he was awarded the Charlemagne Prize in 2004. Today, Poland is still at the heart of Europe. Donald Tusk, the Polish President of the European Council, is convincing evidence of that fact.

Unifying Europe is a topic that has long been very close to my heart. It is particularly close now that I manage the European Stability Mechanism. The ESM provided the rescue loans to the countries that ran into trouble during the euro crisis. We provided a crucial contribution in rescuing the euro.

Today, Europe is a relevant player next to other global powers such as the U.S., Japan, and China. But where the European economy represented 32% of the global economy in 1970, that share now stands at 23%. By 2050, it is projected to be just 9%. Now imagine what the numbers look like for individual countries! Europe risks losing relevance on the global stage, unless we join forces. And despite the many doomsayers, I argue that the EU and the EMU are unprecedented historic successes. The single currency is one of its main achievements. Exchange rate costs of some €20 to 25 billion per year have disappeared. The single market works much better with the euro. Monetary policy is determined by conditions in all 19 member states – and not just by the domestic situation in Germany, as was effectively the case until 1998.

At the height of the crisis, the survival of the euro was widely questioned. But the EMU countries provided financial solidarity to members that needed it. The programmes of the EFSF and ESM were the biggest of their kind that the world has ever seen. My institution wasn't the only one that played a role. The European Central Bank, the European Commission, and national governments also played their part. Europe has come out of the crisis stronger than before. Let me first look at that progress achieved in making our union more robust.

My own institution, the ESM, is a good example. It's a firewall to protect countries if they lose market access. We have a lending capacity of €700 billion. During the last five years, we have disbursed €255 billion to five countries. That's about three times the amount the IMF lent out globally in the same period. We are one of the biggest issuers of euro-denominated bonds. Without the ESM, some countries would probably have been forced to leave the euro. That would have had dramatic and unpredictable consequences both in financial markets and for the economy.

Countries borrowing from the ESM need to implement unavoidable reforms – often painful – in return for their emergency financing. As a result, they have reduced unsustainable fiscal deficits and restored competitiveness. This approach is working. The Irish economy grew by 7% last year. Unemployment was cut in half. Spain had more than 3% growth, and strong employment gains.

The ESM helps countries return to debt sustainability. Our paid-in capital is above €80 billion, which gives us a very strong credit rating. This means our funding costs are low, currently below 1%, and we pass these on directly. The IMF charges three to four times more. Our favourable rates lead to substantial budget savings for programme countries. The Greek budget, for example, saves around € 8 billion every year because of it, or 4% of Greek GDP.

A second achievement after the crisis is the strengthened economic policy coordination and surveillance in the euro area. Let me mention in particular the new Macroeconomic Imbalances Procedure. Countries have also given the Commission additional powers to enforce our new rules, and I do encourage Brussels to make good use of this.

The EMU has also markedly improved its system of banking supervision. The Single

Supervisory Mechanism now oversees the 129 largest and systemically relevant banks. And with the establishment of the Single Resolution Mechanism this year, the first two pillars of Banking Union are in place.

But we must continue to work to make EMU more robust, and to increase its legitimacy. The popularity of the euro provides a strong argument for politicians to continue further reforms. The euro is more popular today than the EU itself. In surveys, about two-thirds of the people in the euro area support the single currency.

To my mind, the two biggest tasks we need to work on are increasing risk sharing, and addressing institutional issues. Risk sharing is important to smooth business cycles in a large country or the euro area, particularly when some regions are hit by an asymmetric shock. In the U.S. – but also in France or Germany – 80% of a shock is absorbed via markets or fiscal channels. In the euro area, it is less than 40%. That makes the euro area less robust than it could be.

There are two ways to strengthen risk-sharing: through stronger financial market integration, which leads to more private sector cross-border financial flows. Secondly, a limited fiscal capacity could also help.

Stronger financial market integration can be achieved by completing Banking Union and Capital Markets Union. In Banking Union, we need to make sure that there is a backstop for the Single Resolution Fund, which is still building up its assets. This is a function where the ESM could well play a role. We also need a European Deposit Insurance Scheme: the third, and final, pillar of Banking Union.

Capital Markets Union is an ambitious programme to allow more financial flows across borders. It will add an important new source of funding for small- and mid-sized companies. In order for this to happen, it will be necessary to harmonise corporate, tax and bankruptcy laws across Europe. This will not be an easy task, but it is an important one.

The better risk sharing via markets works, the less we need the fiscal channel. A number of proposals have been put forward for a limited fiscal capacity to help smooth shocks. They can be designed in a way that does not lead to permanent transfers, or to additional debt mutualisation.

The governors of the French and German central banks – Francois Villeroy de Galhau and Jens Weidmann – have proposed establishing a euro area finance minister. He or she would be the head of a Treasury administration for the currency union, would supervise the fiscal rules, and represent EMU externally. This person could also oversee a limited euro area fiscal capacity.

There are also proponents of setting up a European Monetary Fund, particularly in the European Parliament. This would combine three functions that are currently spread out over the ESM, the Commission and the ECB into one institution. The ESM would be a logical starting platform for such an institution. Finally, some also mention a sovereign insolvency mechanism, which would impose a majority decision on creditors in case of a sovereign debt restructuring. The aim is for the private sector to share more of the burden with taxpayers, and reduce the need for ESM lending. This is obviously a good idea in principle, but it would take a long transition period to avoid market disruption.

I cannot predict which of these ideas will become reality, and when. Some are mutually exclusive. But I find it safe to assume that the euro area will continue to integrate faster than the rest of the EU. The logical consequence of this will be a Europe of multiple speeds. This is – by the way – independent of the outcome of the referendum in the UK.

I know that in Poland such a concept is seen with scepticism and I fully understand that. After Poland’s courageous contribution to end the forced division of Europe, it is perfectly normal that Poles have no desire to find themselves excluded again. But there is no need to.

A Europe of multiple speeds will also need to be a Europe of openness. Any country that does not wish to be part of a more integrated group initially must be able to join later, when it feels it is prepared for this deeper integration.

A pragmatic multiple-speed approach is essential for European unification. Unification – the pooling of sovereignty in certain areas – has never been an easy process. Where some countries agree, others may need more time. When that is the case, the EU has always been able to find a way out. Several instruments to accommodate the various speeds already exist, such as transitional arrangements, opt-outs, enhanced cooperation or annexes to Treaties.

At the core of Europe’s integrated architecture there is the single market. From its humble beginnings in 1957, the EU is now the world’s most economically potent internal market. It is a huge step up from bilateral free trade agreements between countries. It constitutes a much deeper level of integration, guaranteeing the free movement of people, goods, services, and capital.

Countries outside the EU can piggyback on the single market. Members of the

European Economic Area such as Iceland and Norway are united with it and follow the same rules, but are exempt from other EU regulations such as the common agricultural policy. Switzerland is linked to it through a range of bilateral treaties. Nineteen EU members in the single market have gone one decisive step further and established the Economic and Monetary Union. The UK and Denmark did not join, and have formal opt-outs.

Other examples of this variable geometry are easy to find. The Schengen Area was established by 26 countries who did away with their internal borders. Three are not EU members. And by contrast, six EU countries are not in Schengen.

More recently, all but three EU countries concluded the Fiscal Compact, an intergovernmental agreement on euro area fiscal discipline and governance. The ESM was also set up through an intergovernmental treaty. This was during the crisis, when the euro area rapidly needed a rescue fund.

Importantly, the Lisbon Treaty has made the multi-speed approach official. It provides a mechanism for deeper integration in specific policy areas. This is so that countries can overcome blocking minorities. Those that stay out, may join at any later stage.

While such pragmatic solutions are laudable, they also create problems. For example, the EU decision-making bodies – the Commission, the Council of Ministers and the European Parliament – are institutions of all 28 EU members. But the euro area has only 19 members. For voters in the euro area, it is difficult to understand why non-euro countries have a say in decisions that may be of vital importance to euro area countries. This undermines legitimacy.

This is why I believe these institutions need to be adjusted. I am not proposing the creation of new institutions. Rather, I see the creation of subsets of the existing EU institutions. For example, whenever the Commission decides on matters of the currency union, the college would meet and decide with 19 Commissioners instead of 28.

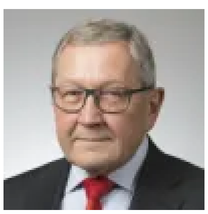
In the Council of Ministers this subset for the monetary union already exists. It is called the Eurogroup, consisting of the 19 euro area finance ministers. But this is an informal gathering. Instead, it should become a formal body, able to legislate.

For the EU Parliament, one could consider an assembly composed of the deputies from the euro area countries, whenever currency union matters are on the agenda.

Obviously, these changes would require revising the EU treaty framework. I know this is very difficult. It is a lengthy process, politically costly, and with no certainty about the outcome. But as we proceed towards a Europe with various degrees of integration, there is no way around changing the EU treaty if we want to strengthen

legitimacy.
Ladies and gentlemen, an EU of multiple speeds offers pragmatic solutions that we could use in the future. It is already a reality that some countries want to be part of a more loosely organised Europe. They have no desire, or no ability, to join a closer union. The same may apply for countries for whom joining is not realistic now, but who may desire to join one day, such as Turkey.
Let me stress that it is crucial that Europe remains open for those wanting to join later. When the euro was introduced in 1999, it had 11 members. Over the years it has steadily grown. Now we are 19. My own institution, the ESM, went through a similar pattern. In 2012, we had 17 members. In 2014, Latvia joined, then Lithuania. I would be very happy if Poland one day decided to adopt the euro. Then you would also become a member of the ESM. When the time is ripe. When it makes economic sense. And when the Polish people want it.
Thank you very much for your attention.

Author



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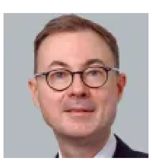

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