# The Next Steps to Make Monetary Union More Robust

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*(Please check against delivery)*

Ladies and gentlemen,

It is a pleasure to be here today, at this important conference. In this room, we are all intimately familiar with the topics on the agenda. We are all involved in the Economic and Monetary Union in some capacity every day. So we can speak as experts among ourselves.

But there is also a risk in that. The risk is that we already agree on the conclusions the conference will reach tomorrow. On what to achieve with monetary union, and how to get there. The risk is that we do not question our own assumptions. That is a very serious risk. Because these days, large parts of Europe’s citizens are not so sure anymore that they trust what the experts are telling them.

European cooperation has brought immense benefits, and countries need to keep working together. Experts - like us - have not always done a very good job in explaining that. My assumption is that you agree that the euro is worth defending. But – given what I just said - let me still spell out why that is the case.

The euro is often described as a purely political project, but that is not correct. We need to remind the public – and some Anglo-Saxon academics – that the economic advantages of the single currency are real. It enables countries to enjoy the benefits of the single market to the maximum. Companies are saving foreign exchange costs of €20 to 25 billion per year. Cross-border trade between euro area countries has received a boost of up to 10%. Transaction costs have fallen sharply. Price transparency has increased, leading to greater competition, which, as we know from economic theory, results in larger productivity gains, and higher growth.

What is less frequently mentioned (and I miss it completely in the work of academic critics) is that the single currency has solved a general problem of monetary policy making in Europe. Before the euro, Bundesbank decisions dictated monetary conditions in many countries outside Germany. Yet because of its mandate, the Buba could only take the economic situation in Germany into account. This often led to suboptimal monetary conditions in other European countries. It is quite similar to what we see globally nowadays, where emerging markets like India and Mexico are heavily impacted by the monetary policy of the Federal Reserve. Because of its mandate, the Fed cannot take this into account, at least not directly.

With the advent of the euro, this problem no longer exists in Europe. The ECB’s policy decisions look at the whole of the euro zone - a big advantage for the countries that use the euro. Some well-known academics argue monetary conditions cannot be appropriate for individual countries, because they are based on the economic situation in the entire area. But they forget that the situation was worse before the introduction of the euro. Not only was it difficult for smaller European countries unable to influence decisions of the Buba. Quite often, it was also hard for Germany, which suffered repeatedly from currency turmoil in Europe. The Tequila crisis in 1995, for instance, triggered a massive appreciation of the Deutschmark against other European currencies (+20% against the Italian lira to name only one). German exports suffered, and this cost the country one percentage point of growth that year.
Such examples show that the EU - and monetary union in particular - are extremely valuable political and economic undertakings. Europe has worked hard to protect

those projects, especially after the euro crisis at the start of this decade. Let me briefly look back.

Europe had to deal with a double crisis. First, starting in 2008, banks were hit by the subprime crisis, which started in the United States. This was followed by the sovereign debt crisis, which was of Europe's own making. The loss of market access for a country that had joined EMU had been considered unthinkable when the Maastricht Treaty was signed. Consequently, there was no mechanism to deal with it. Many predicted the euro would break up. That this didn't happen is only thanks to the decisive and comprehensive action from national governments and European institutions.

Firstly, countries did their homework. They put their fiscal house in order, and adjusted macroeconomic policies. Equally important, competitiveness has returned, and current account deficits have largely disappeared. On top of these national efforts, there is stronger economic policy coordination at the European level.
[SLIDE 1]

The two institutions I manage, the European Stability Mechanism, and its predecessor the EFSF, filled a gap in the institutional framework of EMU. We are a lender of last resort to sovereigns, a function that did not exist before the crisis. The two institutions have provided assistance to five countries: Greece, Ireland, Portugal, Spain and Cyprus. We have a total of €247 billion in loans outstanding, three times as much as the IMF globally. Our loans constitute substantial budgetary savings for programme countries. This is because our lending rates are very favourable: only one-third of what the IMF charges. We have calculated that this saves the Greek budget €8 billion each year, or 4.5% of GDP. This comes at no cost to the euro zone taxpayers, because we fund ourselves by issuing bonds and bills. The ESM can do this cheaply because of its strong credit rating, based on its high paid-in capital of €80 billion.

The other significant institutional innovation that became possible during the crisis is Banking Union, which saw the establishment of the Single Supervisory Mechanism as well as the Single Resolution Board and the Single Resolution Fund.

In short, Europe has undertaken quick and decisive action during the euro crisis to protect the monetary union, and the significant benefits that it brings. Europe has come out of the crisis stronger than before. It has built new institutions in record time and broadened economic governance. The economy is recovering as a result. And people recognize this success. Despite the rise of the populists in the polls, two-thirds of euro area citizens support the single currency. That is a large majority, which should give policy makers some confidence.

With the progress we have seen in EMU, what is still on the to-do list? What remains to be done to make EMU more robust and the economy more resilient?

There are many proposals around, such as the Five Presidents Report, plans from the European Parliament, think-tanks, politicians and several governments. I will mention some of those. But let me first say that the answer at this stage should not always be “more Europe”. We should focus on the essentials and only consider those changes with clearly defined and tangible benefits.
[SLIDE 2]

I agree with Peter on the causes of the lack of risk-sharing between the countries of the euro area, and on what needs to be done to remedy it. It is the biggest remaining gap in the euro area in my view, and filling it would make EMU more robust, and the economy more resilient. Risk-sharing helps smooth the business cycle and makes economies more resilient. This can take place through financial markets as well as through fiscal tools, and there is a trade-off between the two. Both are underdeveloped in the euro area – not only when compared to the United States, but also when looking at what is happening in large European economies. In the US, as much as 80 percent of an asymmetric shock is evened out. In the EMU, it is below 40 percent. It is clear that Europe needs to catch up. So let me propose some measures to promote risk sharing.

First, to enhance risk sharing through markets, it is essential that we complete Banking Union. The Single Resolution Fund - the money that the SRB would use in case of a bank bail-out – needs a financial back-stop to make it more credible in the eyes of the market. The ESM could play that role. We also need a European Deposit Insurance Scheme. This is a controversial topic because the current national systems are different and some countries need to deal with legacy issues. But there are different models for such a scheme and it would certainly strengthen the resilience of the monetary union.
Secondly, work needs to be undertaken on Capital Markets Union, along the lines

proposed by the European Commission. This more long-term and ambitious project strives to harmonize tax, corporate and bankruptcy law, which would make it easier for equity investments and venture capital to flow across borders. It would open up a new source of funding for small- and mid-sized companies, which are the backbone of the European economy. Thus, it would also reduce the dependence of these firms on bank loans.
[SLIDE 3]

A thriving banking industry and a well-functioning Capital Markets Union will enhance the return of cross-border financial integration across the euro area, which saw a broad reversal after the euro crisis. The ECB measures financial integration through an indicator that looks at credit, corporate and sovereign bond markets. They find that financial integration rose in the 10 years leading up to the crisis, when it rapidly dropped. It is now roughly at half its pre-crisis level.

The more financial integration, the more risk sharing through the capital markets channel. This would reduce the need for any type of budgetary assistance across the euro area, including the chance that institution such as the ESM needs to be deployed in the future.

Turning to risk-sharing through the fiscal channel, it is worth reminding you that the EU budget for decades has provided transfers to low-income countries in the EU. While that budget is small – a little over 1 percent of GDP - poorer countries can get support of up to 3 percent of their GDP, which is substantial. Monetary union does not need fiscal transfers in addition to that in my view – it would be different if the EU budget did not exist.

However, it would be worth setting up an additional fiscal capacity for the eurozone for risk-sharing purposes. This can be done without permanent transfers or debt mutualisation, as examples in the US show. Such a capacity could take the form of a rainy day fund or a centrally managed US-style unemployment fund.

Ladies and gentlemen. We are talking today about completing the monetary union. We have made tremendous progress towards that goal in the past six years. The road ahead of us is short  compared to the distance we have travelled. EMU does not need a full fiscal union to be functioning properly. It does not need a full political union either. We have moved sufficiently in that direction since 2009. The steps I am proposing would make the monetary union more robust, its economy more resilient. It is a sensible and pragmatic approach that will be understood by a population that is widely supportive of their single currency, the euro.

Thanks for your attention.

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