

Introductory remarks for the discussion panel ‘The Future of the Euro’

*Speech by Yves Mersch, Member of the Executive Board of the ECB,
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As we are in the quiet period, I am speaking in general terms and not on future monetary policy stance or economic developments.

As the European Union (EU) approaches the 25th anniversary of the Maastricht Treaty, it finds itself at a crossroads. The multiple crises that have challenged Europe’s stability, prosperity and security have undermined people’s trust in the EU. But this is not only a European phenomenon. Nationalistic and xenophobic movements in other parts of the world are vigorously opposing mainstream politics and established politicians. Let’s not forget Churchill’s remark that a referendum tells us less about the question and more about the questioner.

After eight years of crises and subdued growth the issue is about the divide between the haves and the have-nots. On the one hand, globalisation and open borders have created benefits that are perceived to have been appropriate by the well-connected few. On the other hand, the burden-sharing needed to keep our financial systems afloat and preserve our regional community is also perceived as being unfair. The easy way out is to blame EU institutions. Indeed, the EU Commission, the EU Council and the Council of Ministers take many decisions that affect our daily lives. But they are not democratically elected and they cannot be sanctioned either. In this context, the outcome of the UK’s EU referendum is triggering a debate not just on the future relationship between the EU and the UK, but also – and perhaps more importantly – on how to improve the functioning of the EU and of Economic and Monetary Union (EMU) as one of its key elements.

I have a central banker’s perspective, and I believe that the stability of a currency requires trust, cohesion and an ability to act as and when necessary. So today I will be considering how we could boost support and strengthen the institutional arrangements for European integration.

When thinking about what needs to be changed, it is also important to build on the EU’s strengths and to protect our collective achievements. They are too often forgotten: some people ask, what has the EU actually achieved? As if there was no good response.

We benefit from the dividends of our Union day in, day out: peace, democracy and the preservation of economic wealth across the continent based on the four freedoms. *In this respect, the EU and its institutions provide a forum where we can settle disagreements in a civilised manner and arrive at joint decisions. EU law protects our most fundamental principles and exercises significant normative power internationally. In material terms, the EU has facilitated a level of prosperity unprecedented in European history, if only because by ensuring peace it prevented the strife and destruction of the past.*

Our economic union also brings very concrete benefits. The EU brings freedom – the freedom to study, travel, work, invest and do business across the continent. *In opinion polls, this is considered the most positive result of the EU, alongside peace.* Moreover, the euro is a very tangible European public good that is perhaps the strongest guarantee that we will stand together even in times of crisis. *Support for the euro and EMU is very high in the euro area, in fact much higher than support for the EU. The crisis tested our political commitment, and this commitment was reaffirmed.*

Indeed, European integration has brought fundamental benefits. People believe in Europe and European public goods when they are tangible and deliver results. However, we also need to fully acknowledge the shortcomings of the status quo. For many, Europe is a proxy for globalisation, which has created prosperity as well as strong interconnections. Our economies are so intertwined that they can only be disentangled with great difficulty. Consider the complex discussions under way in the UK on how to separate from the EU. Can borders protect us from capital flows, demographic ageing, secular trends in capital return, lower equilibrium interest rates or migration due to wars and human misery? For individuals it is increasingly difficult to distinguish origins at national, at European and at global level. The distortions and half-truths of the Brexit debate has shown that, first, complexity, second, uncertainty about pensions, third, low growth, and fourth, income distribution, offer fertile ground for extremists.

Economically, the pace of recovery in the euro area remains unsatisfactory, with unemployment levels still too high. *This is reflected in opinion polls on the economy and on the outlook for the months to come. It is clear that efforts to strengthen the recovery have to be undertaken.* In the financial sector, remaining fragilities in the banking sector need to be fixed and the banking union completed. *Otherwise, market participants will continue to fear that local vulnerabilities could eventually spread and destabilise the European banking system before all the firefighting tools are ready to be deployed.* The aim must be to move forward swiftly on both risk reduction and risk sharing. Risk sharing involves both the public and private sectors, for example by ensuring the same level of deposit protection through a European deposit insurance scheme, but also by continuing to build a capital markets union in Europe.

The EU and EMU also need to face up to their institutional weaknesses. *On average, people's trust in both national and EU political institutions is very low. As regards the **national level**, we know from the economic literature that strong institutions are crucial for sustainable economic growth and governance indicators suggest that there is room for improvement in many Member States.*

As regards the European level, the gap between people's expectations and the EU's institutional setup is widening:

- First, the perceived legitimacy of the EU remains low. The EU is not regarded as 'efficient' and only a minority of citizens feel that their voice counts in the EU.
- Second, opinion polls suggest that citizens are not opposed to European decision-making. Specifically, they want the EU to concentrate on their key concerns, notably to protect them better from economic and security risks, and to provide solutions.

When responding to these expectations, the EU and EMU face however two challenges:

- The first has to do with subsidiarity: it should be made clearer where the EU has an advantage over Member States in terms of exercising competence and where not. A better demarcation of competences between the European and national level is desirable – but not easy. Loose coordination at European level may give the impression that a competence has been passed to the European level, when in fact it continues to be exercised by Member States. *The result tends to be that the EU gets blamed for apparently seeking to interfere in national affairs when in fact it does not effectively have the power to do so.* It should not be so surprising that in such situations the practical result is a lack of coherent action across the EU. This, in my view, means that responsibilities and accountability lines should be more clearly defined and assigned, as Europe has done with the single monetary policy and the creation of the European Central Bank.
- The other challenge has to do with intergovernmentalism. The rationale for the intergovernmental approach is to ensure that decisions respect national interests. The risk is however that decision-making becomes a diplomatic exercise, resulting in protracted and opaque negotiations, a lack of long-term strategies and national interests being pitted against each other. However, it is an outdated belief that the nation state is the sole locus of legitimacy. The EU is not only a union of Member States but also of citizens. Where competences are assigned to the European level, they should be part of the Union method, with clear executive powers, full democratic accountability and rigorous judicial arrangements at that level. This also means that the EU's agenda should be set by those who were duly elected at European level rather than by a few large Member States. In my view, this would also have to be an essential principle guiding any future treaty revision.
- Decision-making on taxation and public spending is the core prerogative of national parliaments, and for good reason, but that does not mean that we should shy away from further fiscal integration in the long run. We just need to get it right. One of the ideas currently being discussed is a euro area treasury that would be responsible for fiscal policy decisions at European level. Such a treasury or finance ministry would clearly need a high degree of democratic legitimacy and strong parliamentary control. Any college with powers delegated from intergovernmental forums would hardly satisfy those requirements. In my view, the European Parliament convening in euro area composition would be the right body to undertake

this task. It would ensure that the actions of a European finance minister are legitimised at the same level at which decisions are taken.

A common mistake is to underestimate the EU's achievements and the strength of support for tangible European projects such as the euro. But for the EU to regain the trust of its citizens, it needs to be properly equipped to handle destabilising events and respond to people's expectations.

Trust in the currency can also be undermined by extreme measures which have unacceptable side effects. An independent central bank must be able to explain its actions and take account of political economy considerations. Some academic proposals seem to prefer sophisticated models to social psychology. We cannot fulfil our mandate with mathematical equations, but only with instruments that maintain trust in the currency. Extreme measures or legal violations of our mandate are not among those instruments.