CENTRE FOR STUDIES ON FEDERALISM

Altiero Spinelli Lecture

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Jean-Claude Trichet

EUROPEAN ECONOMIC GOVERNANCE: TOWARDS AN ECONOMIC AND FISCAL FEDERATION BY EXCEPTION

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Aula Magna, Università degli Studi di Torino

Jean-Claude Trichet

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AND FISCAL FEDERATION BY EXCEPTION

It is a great honor and a great pleasure to be invited to deliver the lecture Altiero Spinelli, here in the Centro Studi sul Federalismo. The honor is even greater when speaking in front of such a remarkable distinguished audience.

Altiero Spinelli was totally devoted to the European Union. The adoption of his report, as rapporteur general of the Committee on Institutional Affairs, on 14th February 1984, and the approval by the European Parliament of the "Draft Treaty Establishing the European Union" was a magnificent personal success.

It is this vision of Altiero Spinelli which, I trust, is very much alive in Europe that we have to revive. The financial crisis of the advanced economies has clearly demonstrated the necessity to engage resolutely in a more federal institutional framework for Europe.

When people seek a justification for European integration, there is a tendency to look backwards.

In particular that European integration has banished the spectra of war from our continent, is always stressed. European integration has delivered the longest period of peace and prosperity in European history.

This perspective is entirely correct. But it is also incomplete.

There are many more reasons for striving towards "ever closer union" in Europe today than there were in 1945. And these are entirely forward-looking.

65 years ago, the distribution of global GDP was such that Europe had only one role model for its single market: the United States of America.

Today, Europe is faced with a new global economy, reconfigured by globalization and by the emerging economies of Asia and Latin America.

It is a world where economies of scale and networks of innovation matter more than ever. By 2016 -that is, very soon- we can expect the Euro area in terms of purchasing power parity to be below the GDP of China and over and above the GDP of India. Together, these two

countries would represent around twice the GDP of the euro area.

Over a longer horizon, the entire GDP of the G7 countries will be dwarfed by the rapid development of the systemic emerging economies.

Europe has to cope with a new geo-political landscape very profoundly reshaped by these emerging economies.

And Europe is also faced with new global challenges, such as climate change and migration, where effective solutions are possible only at the European and international levels.

In this new global constellation, European integration -both economic and political- is central to achieving prosperity and influence.

The challenge is to set the correct path of European integration. Getting this right is essential to realize fully our continent's tremendous potential. Let me therefore lay out a vision for the Europe of tomorrow.

The creation of Europe's economic and monetary union is unique in the history of sovereign states. The Euro area constitutes a "society of states" of a completely new type. We have created progressively a concept which goes far beyond the Westphalian concept of sovereign states.

Like individuals in a society, Euro area countries are both independent and interdependent. They can affect each other both positively and negatively.

Good governance requires that both individual Member States and the institutions of the EU fulfill their responsiblities.

We have observed the functioning of the Euro area for 13 years. As all advanced economies, we have experienced the shock of the crisis over the last five years. It is time now to draw lessons from these first years.

The acronym EMU -Economic and Monetary Union- is made of three letters E, M and U which means that we must have, and have indeed, two Unions: a monetary union M U, and an economic Union E U.

1. Successes of the Monetary Union

I will not expand too much on the successes of monetary union. Let me only mention the following elements:

First, the new currency, starting from scratch has maintained price stability for an entire continent of seventeen countries and 332 million people. The average yearly inflation over the first thirteen years has been 2.03%.

Second, savers and market participants are

trusting the Euro to keep its domestic value as well in the future. The inflation expectations that one can draw from the financial markets are, for the next ten years, around 1.9% - 2%, in line with the definition of price stability of the ECB.

Third, the track record of price stability and the anticipation of future price stability are not only fully in line with the mandate received by the European Central Bank and the Euro system from the European democracies, but also better than what had been displayed in Europe before the Euro. For example the Bundesbank, exemplary for its capacity to ensure price stability, could display an average yearly inflation from 1955 to 1999 of around 2.9%.

Fourth, this level of stability and of credibility has been attained despite several oil and commodities shocks and the impact of the worst crisis in the advanced economies since World War II.

Fifth, also to be noted, this level of stability was not attained to the detriment of job creation. Since the setting up of the Euro, the 1st January 1999, up to the first quarter of 2012, the Euro area has created 14.1 million new jobs. During the same period, the United States have created around 9,1 million new jobs. This is not to say that there is not a big and grave unemployment issue in Europe: we have still a lot of hard work to do, particularly eliminating with great determination structural obstacles to growth. And in the U.S., an episode of very active job creation took place in the 1990's. Still the comparison, which is not known, shows that there is no obvious inferiority on this side of the Atlantic: all advanced economies have to improve their employment situation.

The success of the currency, the success of the Euro itself, does not explain why Europe is today at the epicenter of the present crisis of the advanced economies. There one has to consider the weakness of the Economic Union.

2. Weaknesses of Economic Union

It is not the Euro area as a whole, on a consolidated basis, which is presenting major weaknesses: the current account of the Euro area is balanced, the public debt outstanding as a proportion of GDP is well below the Japanese public debt outstanding and the yearly public finance deficit is well below the equivalent figures in the U.S., in Japan and in the U.K. Still several factors, in particular the absence of effective surveillance inside the Euro area, have created a large dispersion of situations between countries as regards fiscal soundness, competitiveness and therefore

credit worthiness. This explains why some countries are regarded by investors and savers as vulnerable.

The weaknesses of the Euro area economic governance can be summed up in six propositions:

First, the Stability and Growth Pact designed to ensure sound fiscal policies in the Euro area has not been correctly implemented. Furthermore, in 2003 and 2004, the major countries, namely France, Italy and Germany, engaged in a dramatic move to weaken the Pact. The defense of the Commission, of the ECB and of the small and medium sized countries contributed to avoid the dismantling of the "letter" of the Pact. But the "spirit" of the Pact has been gravely impacted.

Second, the governance of the Euro area did not comprehend monitoring and surveillance of competitiveness indicators, of nominal evolutions of prices and costs in any particular nation and of national external imbalances within the Euro area.

In the view of the ECB, this was abnormal. In 2005, long before the crisis, I called on behalf of the governing council, for an appropriate surveillance of a number of national indicators including the unit labor costs evolution.

Third, the high correlation between the credit worthiness of the commercial banks of a particular country and the creditworthiness of the signature of the sovereign creates an additional vulnerability which is particularly damaging in the Euro area, and calls for a banking union.

Fourth, no crisis management tools had been envisaged at the start of the Euro. One has to recognize in this respect that “benign neglect” was generalized all over the world at the time of the setting up of the Euro, particularly in the advanced economies.

Fifth, another weakness of the Euro area has been the unsatisfactory completion of the single market in the domaine of goods and particularly services. This weakness of the single market of the European Union as a whole -the 27- is particularly resented in the Euro area where it hampers the functioning of the competitive channel essential for a correct adjustment of the economies concerned.

And sixth, similarly the relatively slow implementation of the structural reforms foreseen in the Lisbon agenda and in the 2020 programme which were, and are, engaged at the level of the European Union as a whole, is hampering the smooth functioning of the Euro area.

In many domains, fortunately, important progresses have been made. The “six packs” are incorporating very significant improvements of the Stability and Growth Pact as well as the creation of a new “pillar” for the surveillance of competitive indicators and excessive national imbalances.

As regards the banking sector, I trust that a banking Union, helping to disconnect the commercial banks from the creditworthiness of their sovereign, is an appropriate concept, which has to be implemented as effectively and rapidly as possible.

Very new significant crisis management tools have been put into place. So that the first four weaknesses that I have previously listed are in the process of correction. Very comprehensive expeditious and swift implementation of the measures already decided is of the essence.

And there is a consensus to consider that the completion of the single market and the structural reforms that are overdue at the level of the 27 are important endeavors for the stability and prosperity of the European Union even if there are still resistance here and there.

But as I already said publicly I trust that we have to go further in engineering a quantum leap for economic and fiscal governance. We have to introduce elements for an economic and fiscal federation that would be fully democratic. The Commission is rightly also calling for proceeding in this direction.

I see several avenues that Europe could borrow to make progress in the direction of a more federal economic and fiscal policy.

First, we could transfer at the level of the center some spending (for instance some standardized social protection spendings) that would create a first embryo of a federal budget. This budget would have a limited risk sharing capacity allowing, to some extent, the possibility of shock absorption. But it must be clear that it should not play the role of a permanent transfer of resources from some countries to other. It would have to be designed very carefully so that there would be no net transfer from country to country over the cycle.

A second avenue could be to significantly reinforce the European Stability Mechanism (ESM) to have at the level of the center of Europe a substantial and effective deterrent capacity, in case the speculation segment of the global market would be tempted to test again the resilience of the euro area as a system. Such reinforcement of the ESM would have also the advantage of calling for an additional significant issuance of bonds bearing the

signature of Europe so that the deterrence of the mechanism would be highly credible in the eyes of the market participants.

A third avenue would be associated with a significant change in the process of close monitoring of national policies embedded in the two surveillance pillars mentioned earlier. Instead of imposing fines to the countries that would transgress the rules and not apply the recommendations, I would suggest to "activate" a new decision making process. In these exceptional circumstances, the European authorities, Commission, Council and this is essential- Parliament could decide directly on measures immediately executed in the country concerned. It would be in the domain of the budget and of some part of economic policies a concept of "activation of a Euro area federation by exception".

3. A Euro area economic and fiscal federation by exception

I see several important reasons for such a concept of "activation of a democratic economic and fiscal federation by exception" to be worth exploring.

First, the concept according to which sharing a single currency also means accepting limitations to fiscal sovereignty is not new.

The Stability and Growth Pact comprehends the possibility of imposing sanctions -in the form of fines, including very significant fines- if a government, or a Parliament, or both are not meeting the Stability and Growth Pact provisions and not respecting the Commission and Council recommendations.

The new concept I suggest studying, draws the consequences from the fact that the fines have proved ineffective. But again, limiting fiscal sovereignty in exceptional cases was already in the Maastricht Treaty.

Second, it is in line with the concept of subsidiarity which has been applied since the introduction of the Stability and Growth Pact. As long as the policy which is pursued is in line with the framework, there is no sanctions. When the policy pursued is threatening to contradict the overall limits incorporated in the framework, the procedure leading to sanctions is activated.

Third, perhaps the most important element of the new proposed concept, would be its strong democratic anchoring. One has to be sure that the activation of the "federation by exception" is subject to a fully democratic decision making process, and that democratic accountability is undisputable. That is the reason why the European Parliament should be called to play a

fundamental role in the decision, on top of the traditional role played by the Commission and the Council. More precisely, for the decisions to be effective, the European Parliament would have to approve by a majority vote the measures proposed by the Commission and already approved by the Council. Naturally, as long as the Euro area does not coincide with the European Union as a whole, only the members of Parliament elected in the countries members of the Euro area would vote.

It would be necessary to organize in the best fashion possible the dialogue between the European Parliament and the national Parliament of the country concerned. In these exceptional circumstances, where the stability and the prosperity of the Euro area as a whole would be at stake, the national Parliament should have the possibility of explaining why it could not implement the recommendations proposed. Symmetrically, the European Parliament could explain why the stability and the prosperity of the Euro area as a whole is at stake. That being said, in the activation of this "federation by exception", after a deep and appropriate dialogue between the two Institutions, the last decision would belong to the European Parliament.

Fourth, the legitimacy of the participation of all members of the European Parliament elected in Euro area countries seems to me very strong. It would indeed be their own electorate's stability and prosperity which would be put at risk in such exceptional circumstances where one particular economy behaves dangerously.

The Euro area is presently learning the hard way that the level of interconnectedness between economies inside a single currency area is such that even an economy of a modest size can impact significantly the Euro area as a whole.

Fifth, even in a very long term perspective, it may appear appropriate for the European future federation to adopt such a concept of "activation by exception" of the economic and fiscal federal governance. The scope of interventions and the measures taken by the federal institutions would so rely on the principle "as little as possible in normal times, but as much as necessary in exceptional times".

These are new ideas which might be worth examining. I have had occasions before to suggest the setting up of a ministry of Finance of the Euro area. This ministry would have the responsibility of the activation of the economic and fiscal federation when and where necessary. It would be responsible for the handling of the crisis management tools like the ESM. It would also be responsible for the handling of the banking union. And it would represent the Euro area in all international institutions and informal groupings, G7, G8, G20, etc.

The minister of Finance, in charge of this ministry, would be member of the future executive branch of the European Union, together with the other ministers responsible for the other federal departments.

In this perspective, the Commission would appear naturally to be the anticipation of the future European democratic government as has been suggested by Minister Wolfgang Schäuble, in his recent Karl der Grosse prize speech, with his proposal for an election of the President of the Commission. The Council appears to be the anticipation of the future European upper chamber. And we already have the lower chamber already elected by all European fellow citizens.

I am fully aware of the boldness of some of the ideas presented here. But I really think that it is necessary for the Europeans -as well as for all advanced economies- to draw all the lessons from the past and present events. It is time for us to clarify the nature of the "quantum leap" that is necessary for our future governance. One thing is sure: this governance would have to be fully effective when demanded by circumstances. It would have to be fully democratic with a deep and decisive involvement of the European Parliament.

Altiero Spinelli said famously:

"La federazione europea non si proponeva di colorare in questo o quel modo un potere esistente. Era la sobria proposta di creare un potere democratico europeo".

Jean Monnet, for his part, once said: "People only accept change when they are faced with necessity, and only recognize necessity when a crisis is upon them". I strongly believe it is time to move ahead.

LECTURE ALTIERO SPINELLI

The Centre for Studies on Federalism organises an annual Lecture on European issues named after Altiero Spinelli, one of the fathers of European federalism. The 2012 Lecture has been given by Jean-Claude Trichet.

Altiero Spinelli (1907-1986) during his internment on the island of Ventotene, together with Ernesto Rossi and Eugenio Colorni, wrote the *Manifesto per un'Europa libera e unita*, better known as *The Ventotene Manifesto*. In 1943 in Milan, he founded the Movimento Federalista Europeo (European Federalist Movement) and in the following years, in Paris, he took part in the foundation of the European Union of Federalists. He was a member of the European Commission from 1970 to 1976 and a member of the first European Parliament elected by universal suffrage in 1979. Spinelli was the inspirer of the Treaty Establishing the European Union, with marked federal features, adopted by the European Parliament in 1984.

Jean-Claude Trichet born in Lyon in 1942, is one of the protagonists in the construction of the European Economic and Monetary Union. He was Director General of the Treasury in France (1987-1993), Governor of the Banque de France (1993-2003) and President of the European Central Bank (2003-2011).

Centre for Studies on Federalism
Via Real Collegio, 30
10024 Moncalieri (TO) - Italy
Tel. +39 011 670 5024
Fax. +39 011 670 5081
info@csfederalismo.it
www.csfederalismo.it