Conférence Theodor Waigel & Jean-Claude Trichet

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Ancien Président de la Banque Centrale Européenne

Gouverneur honoraire de la Banque de France

Vingt ans après :

l'Euro a-t-il tenu ses promesses ?

The Euro is a Historic Success

Monsieur le Gouverneur et Cher François,

Monsieur le Ministre et Cher Theo,

Mesdames et Messieurs,

Es ist für mich eine große Ehre und eine große Freude hier, in Banque de France, mit meinem angesehenen Freund Theo Waigel zu sein.

Thank you again Mr. Governor for this invitation addressed to the eminent Minister of Finance of Germany and former President of CSU-Partei and to myself.

I could see during many years the extraordinary dedication of Theo Waigel to support the Euro project, including in very difficult times. Without the determination of Theo Waigel, the history of Europe would have been very different. That personal determination and courage proved decisive at moment when it was highly doubtful whether there was a majority in the Bundesrat for the single currency.

I would also stress that Theo was equally and strongly determined both on pursuing the European project of the euro and on calling for strict respect of the provisions of the Stability and Growth Pact. Your "Drei komma-null" mantra became legendary.

When reading academic works, published observations, articles signed by specialized journalists as well as articles for a large public, I would sum up a good deal of the negative remarks made on the euro in the following fashion:

"There is a broad agreement that the euro had been a disappointment. The single currency economic performance was very poor, particularly in comparison with the USA and with the average advanced economies. The impact of Economic Monetary Union (EMU) on public opinion in member countries was negative, dividing countries and eroding confidence in the European project. Regarding the future, there is a high degree of pessimism over the capacity of EMU to reform itself decisively and, equally, a high degree of pessimism over the ability of governments in the Euro area to obtain from their public opinion a consensus for necessary integrationist steps."

I think personally that this is a wrong view, which does not represent reality, is deeply misleading and can drive foreign governments, leaders, economic agents and market participants to make wrong decisions. The fact that there is a significant international view which is not correct does not really surprise me: the existence of a significant negative bias against the single currency has been observed since the effective inception of the euro.

Claiming that the euro is a historic success, I accept that the audience might consider that I am biased positively in favor of this European endeavor. It is true that I had the honor and privilege to participate actively in the preparation, inception and management of the single currency. I was advisor to the French President, Valéry Giscard d'Estaing, when he launched, together with the German Chancellor Helmut Schmidt, the European Monetary System and its Exchange Rate Mechanism (1979). I was Assistant Secretary and then Undersecretary of the French Treasury (1983-1993) when France decided to pursue a bipartisan economic policy of "competitive disinflation" designed, in particular, to reinforce economic and monetary integration. As Undersecretary of the Treasury, I negotiated the Maastricht Treaty very much with my German colleague, Horst Koehler, former President of the Bundesrepublik, who was getting his instructions from Theo Waigel. As Governor of the independent Banque de France, succeeding Jacques de Larosière in 1993, I had the responsibility to drive the French franc towards the single currency from 1993 to 1998. From 1998 to 2003, I was a member of the Council of Governors of the European Central Bank. From November 1st 2003 up to end of October 2011, I was President of the ECB and signed during 8 years all the euro banknotes.

So, from 1979 to 2011, it is 33 years that I worked on the single currency concept and implementation. I accept that one could say that I am necessarily biased in favor of the euro. At the same time, the fact that I could spend a third of a century on the single currency demonstrates in my eyes that we are not speaking of a short-term experiment promised to quick failure but of a longer term endeavor which has an historic dimension. By the way, a better computation of the period over which single currency was envisaged and implemented would start with the Werner Report (1970) which proposed for the first time EMU (Economic and Monetary Union) and reaches today (namely 2018). This represents a period of 48 years – around half a century.

In any case, biases of all kinds, negative or positive, should be eliminated from the present analysis. I will try to keep to the facts and only to the facts in all the dimensions of the single currency I will explore. I will make the four following points:

1. Contrary to many negative predictions, the euro, as a currency, is a remarkable success in terms of **credibility** and **stability**.

2. The euro, as a currency, and the Euro area, as a single market with a single currency, proved a remarkable **resilience** in the worst global financial crisis since World War II. The Euro area was quick, imaginative and flexible to learn lessons from the global financial crisis.

3. The euro and the Euro area were and are benefiting from a large **popular support**, which explains largely their resilience in the crisis.

4. The Euro area is a success in terms of **real growth** measured during the period starting from its inception until today.

Overall, the success of the euro and of the Euro area in terms of **credibility, resilience, adaptability, popular support and real growth** during its first 20 years is impressive. It justifies **reasonable optimism** as regards the long-term success of this unique, ambitious, historic endeavor of the Europeans. Naturally, history is in the making in Europe. The course of human history is unpredictable! But this historic unpredictability does not justify a negative bias on the European project. It is about time for the international community to get rid of this bias.

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1. A SUCCESS IN TERMS OF CURRENCY CREDIBILITY AND STABILITY

In January 1999, the euro started from scratch. The exchange rate was 1.17 US dollar for one euro. There was no doubt for most of the observers and economists outside continental Europe that the euro would not stand at par with the dollar in terms of credibility, medium and long-term capacity to keep its domestic and international value. The idea that a currency born in particular from the merger of the Dutch guilder, the DM, the escudo, the peseta and the lira would overtime inspire a high level of confidence, appeared then to be very presumptuous.

At the time I am speaking, the euro-dollar exchange rate is around at the same level, namely 1.16 US dollar for one euro. The overwhelming majority of economists and market participants have no more any doubt on the capacity of the euro to keep its international value. During a significant part of the first 20 years of the new currency, remarks were made on the fact that the euro was much too solid and too strong, which was highly paradoxical for a currency deemed to lack credibility at its inception!

The international credibility and success of the new currency are confirmed by facts and figures: the euro is by far the second international currency after the dollar. According to the ECB ("The international role of the euro", July 2017), it represents 22% of the "*international debt outstanding*" (63% for the dollar, 2.6% for the yen).

In terms of "*global payment currency*", it represents 31.3%, approximately ten times the percentage for the yen and not far from the dollar (42.1%).

It amounts to around 20% of foreign exchange reserves, approximately one third of the dollar foreign exchange reserves and five times the yen reserves.

This flattering situation does not mean that the use of the euro goes upward in all circumstances. It goes up and down from time to time and the negative impact of the global financial crisis was visible in the past years. This has been the case, in particular, for the outstanding amounts of international loans and for the share of the euro in outstanding international debt securities. That being said, the euro is the unchallengeable second most important currency. I would add two remarks on this point. First, the International Monetary System is called to change structurally with the growing presence and use of the renminbi which is likely to contribute to significant changes both for the dollar and for the euro. Second, it is important to be aware that the ECB never engaged in any battle against the dollar. I always said publicly that the euro was set up for improving the European single market economy and not at all to fight the US and the dollar. It is obvious that currencies battles are amongst the worst possible events in terms of economic and financial consequences.

The international credibility of the euro is echoed by its domestic, pan-European stability. The ECB made clear from its inception that it had a definition of price stability that would be the yardstick to judge its capacity to deliver stable prices: less than 2%, quickly clarified in 2003 as "less than 2% but close to 2% in the medium run".

In terms of price stability, it was a very ambitious goal, even more demanding than the performance of the best European currencies (yearly average inflation for the DM in the 40 years before the euro inception: 2.9%, covering the 60's, 70's, 80's and 90's). Since its creation, the average euro inflation is around 1.75%. It is an impressive result over around 20 years, in line with the definition of price stability, less than 2% but close to 2% in the medium run.

This does not mean that inflation should be close to 2% every year. The delivery of price stability has to be judged over a medium/long term period. For instance, the most recent period was marked by threats of deflation and years of very low inflation, which the ECB fought with determination. When I left the ECB at the end of 2011, average 2011 inflation rate was 2.72%, significantly higher than 2%, and average yearly inflation since the inception of the euro was 2.07%. What counts from the Central Bank standpoint – whatever external and domestic circumstances are – is to take the right decisions aiming at stabilizing medium-term inflation expectations and effective inflation in line with our definition of price stability.

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2. <u>THE EURO AND THE EURO AREA PROVED IMPRESSIVE RESILIENCE IN THE WORST GLOBAL FINANCIAL CRISIS SINCE WORLD WAR II</u>

In very turbulent times, the euro, as a currency, and the Euro area proved remarkable **resilience**.

At the inception of the euro, a significant global analysis, outside continental Europe, was not only that the single currency would not inspire confidence, but also that it would be short-lived, as a kind of audacious experience deserving some respect for its boldness but incapable to sustain the difficulties of hard times. In this view, the capacity of the currency to hold in the worst economic and financial circumstances would appear as a miracle. This explains why so many eminent economists predicted the end of the European endeavor after the start of the financial crisis and, particularly, after the start of the sovereign risk crisis, the epicenter of which was in Europe and more precisely in the Euro area.

It was clear that the localization of the sovereign risk crisis in the Euro area was due to specific European errors as well as the US localization of the epicenter of the subprime and the Lehman Brothers crises were due to mistakes made in the US. I see six main reasons why the Euro area had to cope with this specific crisis:

- First, refusal to fully apply the rules of the Stability and Growth Pact (SGP) before the crisis;
- Second, absence of close monitoring of the evolution of the cost competitiveness of member countries and of associated domestic and external imbalances. This was one of the major *lacunae* in governance of the EMU from the start;
- Third, absence of banking union;
- Fourth, absence of a specific instrument to fight against speculation (no European Stability Mechanism at the beginning of the crisis);
- Fifth, poor implementation of needed structural reforms all over the Euro area;
- Sixth, absence of full achievement of the single market, particularly in the service sector.

The underlying concept of the Euro area was EMU, namely Economic and Monetary Union. The “Monetary Union” was undoubtedly there: one single currency, one exchange rate *vis-à-vis* other currencies, one single credibility, one inflation at the level of the single currency area. The “Economic Union” had *lacunae* in its design and was very poorly implemented before the crisis. All taken together, the economic, fiscal and financial governance of the whole euro area was suboptimal.

That being said, most external observers missed three points when the sovereign risk crisis erupted in 2010 and 2011.

The first mistake was to consider that all member countries were in a crisis situation. As a matter of fact, out of the15 countries members of the Euro area at the time of the Lehman Brother bankruptcy, 5 of the countries (namely one third) representing a little more than one third of the GDP of the Euro area had very grave economic, fiscal and financial problems. The paradox of the Euro area was that the area included both the worst public signatures in the eyes of the market participants (for instance Greece, Portugal, etc.) and the best ones (Germany, Netherlands, Austria, etc.) among the advanced economies. The euro, as a currency, was reflecting the average situation of the Euro area and not only the part of it which was in crisis, which represented a minority.

Seen from this standpoint, the remarkable resilience of the euro, as a currency, was not a miracle.

The second mistake was to underestimate the capacity of the Euro area to adapt, to defend itself in these difficult circumstances, to correct its weaknesses in terms of economic governance and to demonstrate both solidarity at the level of the area and strong national capacities to adjust in the crisis countries. In the crisis, the Stability and Growth Pact (SGP) was reinforced, the Macroeconomic Imbalance Procedure (MIP) was set up, Banking Union was created and the European Stability Mechanism Treaty signed and ratified. All four first weaknesses mentioned earlier were corrected. Ireland, Portugal and Spain in particular demonstrated a real capacity to adjust.

The third mistake was to neglect the attachment of people in the Euro area to the single currency. It is this popular support that explains the capacity of the Euro area to adapt, to be flexible and to prove a remarkable resilience. I will go back to this impressive popular support demonstrated in the heat of the crisis, both in Greece and in Germany.

To make the long story on the resilience of the Euro area short, let me mention only the fact that 15 countries were members of the single currency area on September 15, 2008, the very day of the bankruptcy of Lehman Brother. All 15 are still members today, including Greece. And 4 new countries (Slovakia, Estonia, Latvia and Lithuania) came in, after the start of the global financial crisis, so that the Euro area includes now 19 countries. Which better refutation of the fragility of the area than a significant expansion in a period of major financial crisis?

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3. <u>THE POPULAR SUPPORT WAS AND IS IMPRESSIVE</u>

The conventional wisdom was and still is that popular support was dramatically lacking for the European integration project and particularly for the euro and for the Euro area. This belief was reinforced by the unexpected success of a political populist force in the UK and in the US. It appeared quite natural that a political wave characterized in particular by nationalism, protectionism, mercantilism and xenophobia would be present in continental Europe and would have also a strong anti-European Union component, as was the case in the UK for instance.

It is unchallengeable that the frustration of public opinion, generalized in the advanced economies, is also present in the European Union and in the Euro area. But the paradox is that this dissatisfaction is directed significantly more towards national governments, parliaments and national institutions, than towards the European institutions (Commission, Council, European Parliament).

The last Standard Eurobarometer published in spring 2018 is particularly interesting. Overall 42% of Europeans “tend to trust the European Union”, significantly more than those who “tend to trust their national government and their national parliament” (34%). This tendency is even more impressive when comparing the proportion of citizens that “tend not to trust” (48% for the European Union, much less than the 61% for national governments and 60% for national parliaments!).

All taken into account, the overall support for European Union at 42% in 2018 is higher than during the entire period since the start of the sovereign risk crisis.

The support of the euro, inside the Euro area, is high and much higher than the perception of global observers. 74% of citizens of member countries approve the sentence: “A European economic and monetary union with one single currency, the euro”, while 20% are against the sentence. The fact that this approval is significant is confirmed by the response of the citizens of the UK (27% approve, 62% disapprove). The approval of that sentence was never below 62% (2013) since the Eurobarometer survey started. The present proportion of 74% is the highest one in the survey.

One of the most frequent errors made by observers outside the Euro area was that the euro was rejected by public opinion. This mistake was particularly frequent at the peak of the sovereign risk crisis. I was often confronted to the view that the Greeks were massively in favor of leaving the euro to avoid "austerity" and that the Germans would massively take advantage of the crisis to get back to their previous national currency, the DM. Nothing was more wrong! The Greeks were massively in favor of preserving their euro-participation! And the Germans were (and are) strongly in favor of the euro. In 2018, 83% of the Germans are approving the sentence on the euro (with 14% disapproving it). I think, Dear Theo, this is the most remarkable homage you are receiving from your fellow citizens. And 69% of the Greeks are approving the same sentence (with 27% disapproving it). The Italians, who are the most skeptical in the Euro area, still approve the sentence (61%, 29% disapproving). It is interesting to note that the support for the Euro is affected positively or negatively by national economic developments, but the balance is still significantly favorable in countries heavily affected by economic difficulties.

This popular support, so contrary to the global conventional wisdom outside Europe, is fundamental. It is that constant popular support which explains largely the remarkable resilience of the euro and of the Euro area.

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4. THE EURO AND THE EURO AREA IS MUCH MORE OF AN ECONOMIC SUCCESS THAN IS GENERALLY RECOGNIZED

Even if the average global observer can be reasonably convinced that, all taken into account, the single currency was a success in terms of stability and credibility, that the Euro area demonstrated extraordinary resilience in exceptional circumstances and that a surprising but unchallengeable popular support is accompanying this historic European endeavor, there is a negative dimension which will immediately be presented as the ultima ratio: the euro and the Euro area are an indisputable real economy failure!

Comparing the Euro area to the United States, the economy weakness of the single currency area appears at first look unchallengeable. But it is because of two optical illusions.

First, the nature of the comparison of the real growth figures: usually done in absolute terms, not taking demographics into account. Then the comparison is always to the advantage of the US which benefits from a yearly positive demographics differential of around + 0.8%. Second, in the most recent period, real growth in the Euro area was hampered not only by contagion of the global financial crisis of 2007-2008 but also by the sovereign risk crisis of 2010-2013, the Euro area being at its epicenter. The recovery started in the US mid-2009 while the recovery in the Euro area started several years afterwards (in 2013).

The correct judgment should, in my view, start with the setting up of the euro – January 1999 – up to now, namely the same period of almost 20 years already mentioned. It seems the most pertinent period of time for three reasons: first, it corresponds precisely to the period of the euro; if the euro is responsible for economic failure, it should be visible. Second, it is a period sufficiently long to cover more than an economic cycle. Third, it is sufficiently far from the start of the global financial crisis not to be too influenced by the various episodes of the crisis on the real economy of the US and of the Euro area.

That being said, where do we stand?

To be sure that my comparison between the US and the Euro area would be as sure and correct as possible, I will stick to IMF figures. According to the IMF (IMF Data Mapper, GDP per capita current prices – WEO, April 2018), the 1999 GDP per capita of the Euro area was 22.310 dollars compared to 34,600 dollars in the US. According to current projections, the respective GDP per capita in 2018 would be 42,070 dollars and 62,150 dollars. The dollars are current dollars over the period.

These IMF figures suggest multiplication of the GDP per capita by 1.89 in the Euro area and 1.80 in the United States. The difference, to the advantage of the Euro area, is very modest and does not suggest a significant advantage. But it does not confirm the dramatic failure that is *quasi* universally, but wrongly, part of the conventional wisdom.

I wanted to make sure that I was not computing an exceptional starting year in picking up the year of the start of the euro. I embarked on the same computation for the year 1998. I also retained the year 2000, even if I was expecting it would perhaps be a too flattering starting point for the euro area, because of the European recession driving down the GDP per capita in 2000 in comparison with previous years.

Relying on the same IMF figures, I had confirmation of the fact that the Euro area has not underperformed the US on a per capita basis. For 2000 as starting year, the multiplier is 2.07 for the Euro area and 1.70 for the US, which I frankly considered too good for the Euro area. I was right to beware of too positive figures for the Euro area. For 1998 as the starting year, the multipliers were exactly the same: 1.89 for both the US and the Euro area (according to the IMF, 22,310 and 32,930 current dollars for respective GDP per capita for the Euro area and the US in 1998, and respectively 42,070 and 62,150 current dollars for 2018 projections).

The bottom line is that there are no figures, over these periods of approximately 20 years, which would suggest that the Euro area, as a whole, is the dramatic real economy failure that is so often claimed.

Statistics, even produced by the IMF, have always to be examined carefully. Even if an overwhelming majority of the GDP of the Euro area was set up at the inception of the Euro (the first “11” and then “12” with Greece), the additional 7 (Slovenia, Malta, Cyprus before the Lehman crisis and Slovakia and the three Baltic States after the Lehman crisis), despite the fact that they are small or very small economies, are certainly contributing positively to growth of the whole area because they started from weak situations in terms of GDP per capita. But it cannot explain fully the difference I am stressing between perception and reality of the Euro area growth per capita.

I will make another remark on the real economy performance of the Euro area. It is often suggested that countries outside the Euro area did better, and even much better, than countries inside the single currency since its inception. Of course, it is always possible to find a very bright European economy doing much better than the average of the Euro area – Norway and Switzerland, for instance, being certainly cases in point. But I had the curiosity to compare the Euro area with the UK over the 20 first years of the euro. Contrary again to common belief, the IMF statistics are giving a significant advantage to the Euro area vis à vis the UK in terms of growth of GDP per capita whatever the starting year is: in terms of current dollars, the multiplier in the UK is around 1.58 when the same multipliers, as already mentioned for the Euro area, are respectively 1.89, 1.89 and 2.07 for starting years 1998, 1999 and 2000. *Vis-à-vis* the UK, if we trust the IMF figures, the catching up process is very visible. At the inception of the euro, the GDP per capita of the

Euro area was around 21.5% below the UK level. In 2018, the IMF projection put the Euro area around 5% below the UK level.

This surprisingly encouraging situation of the Euro area in terms of real growth per capita does not mean that the Europeans can be satisfied. The GDP per capita of the Euro area remains significantly lower than in the US and a vigorous catching up process should be at stake. The Euro area has to do better and much better in many areas. Due to lack of appropriate structural reforms, unemployment, particularly youth unemployment, is much too high. Due to absence of needed structural reforms and absence of full completion of the single market, particularly the single market of services and financial services, Europe and the Euro area are not innovative and creative as they should and as the US – and also China – are in terms of High-Tech and IT new businesses. Also in the domain of education of excellence and universities at the global level, the Euro area is at a disadvantage in comparison with the United States and the UK.

A last remark on the real economy of the Euro area: it is frequently observed that, contrary to expectations and promises, the convergence of standard of living of member states was very disappointing and that after a period of rapprochement before the crisis, new divergences were displayed in the crisis and after the crisis between countries and groups of countries inside the Euro area. I think such remarks are partially based on a misunderstanding. If there is no doubt, in my mind, that the single currency offers additional new economic opportunities, and additional new potential for growth to all member countries, it does not mean that belonging to the Euro area is a guarantee of attaining the highest level of national GDP per capita. Whether participating in a single currency area or not, the level of GDP per capita depends also heavily, in particular, on the quality of the national economic management and on the progress made in terms of productivity. For instance, nobody expects the State of Mississippi to have the same standard of living per capita as Massachusetts or the State of New York (respectively 31,881 dollars in 2017, 65,545 dollars and 64,579 dollars), only because the three States all belong to the single market with a single currency of the USA. And yet the USA is an achieved political federation with a federal budget and a functioning single capital market. According to 2017 figures, the Portuguese or the Greek standards of living – respectively 23,116 dollars and 23,027 dollars – are a little closer to the German one (46,747 dollars) than Mississippi to New York State…

I am not suggesting that there is no inequality issue in Europe, that the present economic catching up exercise inside the Euro area is satisfactory or that the Europeans would not be better off with a much lower standard deviation between GDP per capita of member countries. It is also clear that we had a poor economic management of the whole area in the first years of the euro with a number of poorer countries apparently converging rapidly towards the wealthier ones, but to the price of sustained divergences, namely major domestic and external imbalances. This was before the financial crisis. After the crisis came the economic and financial adjustment which was the reverse tradeoff between macroeconomic divergences and convergences, this time with lower growth and painful adjustment accompanying the return to fiscal and current account more balanced situations.

The long-term goal of Europeans should be to run optimally their single currency economy, avoiding the kind of sustained divergences that created the sovereign risk crisis and, at the same time, to give all their chances to member countries and to the area as a whole to catch up in terms of standard of living and job creation.

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Going further

The success of the euro, as a currency, and of the Euro area in terms of **credibility, resilience, adaptability, popular support and real economy success** does not mean that the Europeans should or can rest on their laurels! It is exactly the contrary. They have a lot of very hard work to do to make a full historic success of their extremely bold strategic endeavor. The first 20 years are, in my view, demonstrating that they were right in engaging on what is probably the most audacious economic and monetary structural reform ever attempted in times of peace.

A historic endeavor is necessarily history in the making. I see many avenues for European progress in the years to come.

First, one should not forget that European Union has many other dimensions than the economic and monetary ones. Domestic and external security, fight against terrorism, control of the borders, monitoring of immigration, and defense are all areas where it is obvious that there is no pertinent national solutions but possible European correct responses at the level of the continent. It is also comforting to note that there is a large popular support to make progress in these fields, according to the Eurobarometer survey.

Second, in the specific domain of Economic and Monetary Union, I see five major recommendations to improve both responsibility and solidarity within EMU and to reach the ultimate economic goal for all national economies and for the single currency area as a whole: sustained growth, full employment and catching up the most advanced economies in terms of standard of living.

1. Achieve rapidly what has already been decided as regards Banking Union, both in its deposit guarantee and resolution dimensions.

2. Apply the rules of the two major pillars of economic and fiscal governance: the Stability and Growth Pact (SGP) and the Macroeconomic Imbalance Procedure (MIP), which are equally important.

3. Design a Minister of Finance of the Euro area, who would preside over the Euro Group of Ministers of Finance, would be vice-president of the Commission and would concentrate exclusively on the economic, fiscal and financial governance of the single currency area. I was the first to make this proposal on the occasion of my Charlemagne speech in Aachen in 2011[1].

4. Reinforce the democratic legitimacy of EMU in giving the last word to the members of European Parliament (elected in the Euro area) in case there is a conflict between the government of a particular country and the European institutions (Commission and Council) on the implementation of the Euro area governance. I made this proposal in 2013[2].

5. Set up a budget of the Euro area (still modest at its beginning), which could start as being designed to help problem countries to engage in the needed structural reforms.

The past and present history of European integration proves the truth of the say of Jean Monnet: "*Premature ideas do not exist, one must bide one's time until the right moment comes along*".

I take it that it remains true for the future of Europe.

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[1] Jean-Claude Trichet - « Building Europe, Building Institutions » - Karlpreis speech, June 2, 2011.

[2] Jean-Claude Trichet - « International Policy Coordination in the Euro Area: Towards an Economic and Fiscal Federation by Exception » - Journal of Policy Modeling, 2013.