The European Institute
"The Future of the Euro"
A Discussion with Jean-Claude Trichet
October 10, 2014

When we speak of Europe, I would say we should never forget that Europe is - and the euro area in particular - a big, advanced economy. You have in Europe all the problems of the advanced economies, and you know that the crisis is a crisis of the advanced economies. All advanced economies at that very moment in '07, '08 were in crisis. Japan had started before. But it was the first time that you had a dramatic financial crisis simultaneously in the U.S., in Europe, in the UK, and in the euro area. On top of that, the euro area has all the problems which are associated with an extraordinary boldness.

The idea that you create a single market with a single currency out of sovereign countries. An experiment that has never been done anywhere in the world, that is totally new, that is objectively extremely bold. And the paradox is that before the crisis, when the rest of the world was saying - and I have to say from the new hemisphere - very, very eloquently, but it's too bold. You are prone to failure.

How can you embark on such a bold adventure? For the Europeans, it was exactly the contrary. For the Europeans, it was nothing but natural. It's absolutely natural to unite the continent, to have a deep union and deeper and deeper union between the European countries. You can explain that, of course, with very ancient roots that probably go back to the Roman Empire. All of the good and bad experiences, the bad experiences of the last two centuries with four dramatic wars on the European Continent, including, of course, the two World Wars. So for the Europeans, nothing but absolutely natural. For the rest of the world, extreme boldness.

The reality is that the rest of the world was probably right in saying it was really extremely bold, and we could see that in the crisis, and that the Europeans were right in saying it was something which was our own historical endeavor. It will hold , whatever the external circumstances are. Even if a dramatic financial crisis was coming from the U.S., but of course. it was global since the very beginning.

Now, my first message to an American audience would be: don't underestimate the resilience of the Europeans, and don't underestimate the resilience of the historical endeavor which is at stake. First, we had, of course, the worst financial crisis since World War II, which could have been perhaps the worst financial crisis since World War I. The euro as a currency was never put into question. Since the start of the crisis, since the subprime, up to now, the euro value vis-à-vis the U.S. dollar has been constantly higher than the introductory level which was 1.17. For our currency which was [according to commentators] prone to disappear, evaporate, and be destroyed, one has to accept that it is quite the contrary.

Global investors and savers never, never lacked confidence in the European currency. That is, again, something which is absolutely remarkable and was not expected by most external observers. And I will not count the money which was lost by those who were betting at a certain moment on the euro to disappear as a currency.

Now, what is perfectly true is that the survival of the entity, the euro area, was really at stake. There is no doubt about that. We had a number of countries inside the euro area that were in an absolutely dramatic situation: Greece, Ireland, Portugal, Spain, Italy, in some respect, were together with Cyprus. These six countries were under stress; and when I say stress, I mean it, a dramatic stress at certain moment. Namely, at four dramatic moments. Once was in May 2010.

Another dramatic moment was August 2011, and mid 2012 was the last dramatic moment. The first two I had to cope with as the President of the ECB. The last one, it was Mario (Draghi).

If you look at what happened under those dramatic circumstances and in an environment where I would say 90 percent of the external observers at certain moment would have said perhaps the Euro will stay as a currency, but the euro area cannot stay as it is. We all heard that. We all discussed that with colleagues, with financiers, with economists, with academics. The fact is that the 15 countries that were in the euro area at the moment of the Lehman Brother bankruptcy are still in the euro area, including Greece, including Ireland, Portugal and the like. The fact is that on top of that, three countries that were not member of the euro area came in since the collapse of Lehman Brothers; Slovakia, the two Baltic states -- three. We were 15. At the moment I'm speaking, we are 18. Next January, as everybody knows, we will be 19 because Lithuania will join.

For an entity, a concept, which was, again, considered quasi-dead not a long time ago, realizing that not only it maintained its existence, preserved its own existence, and augmented quite considerably, because four new countries means at the moment of the crisis, we were 15, so one fourth, an augmentation of one fourth of sovereign countries. I don't say that to say we are in the best of the possible worlds or that there is no problem. On the contrary, I'm absolutely convinced that we have a lot of problems, a lot of very tough problems, a lot of difficulties. But at least, I would expect the external observers, financiers, academics and so forth, to consider that on the resilience of the enterprise of the Europeans, they have to review a little bit their analysis.

Why do they have to review their analysis? Because on top of all the technical, monetary, economic, and institutional construction, you have something which is much more profound and which is kind of a profound strategic, geo-strategic political will to deepen the European construction. And to be sure that peace, that stability, that prosperity on the continent would be ensured, taking into account all of the experiences of the past. So that element which is of historical nature has to be also accounted for to understand better where the Europeans are.

Now, let me go very rapidly on, where are the problems and what can we say about the future? The problems are - in my opinion - that the Europeans, not realizing the boldness of their endeavor, neglected to have a correct governance of the euro area. I will go very, very fast on that because I think it's very well-known. The Stability and Growth Pact, which was one of the quid pro quo for the fact that we had a single currency but no federal institutions and no federal budget, was considered too tight a jacket. Considered so by the Europeans, unfortunately, including France and Germany and Italy, which had the presidency of Europe at the time, at the end of '03 and in '04, you had the demolition of the Stability and Growth Pact, as it was. The letter was preserved, but the spirit was really demolished.

I have to say that the truth of "too tight a jacket" was there. It reminds me a little bit of what I see today, namely flexibility. Be as flexible as possible. After all, we all need flexibility, growth versus austerity and so forth, which I believe might be appropriate for countries that have absolutely no external constraints and perhaps consider that structurally they are very solid and sustainable in the long run. Every country has to judge its own situation from that standpoint, but it's certainly not appropriate for countries that just experienced the fact that a sudden stop of their financing could appear. So they are pegged to know that the external constraint exists. And that at certain moment, you are entering the area of nonlinear economics where you cannot say the more I'm spending, the better I am, because at a certain moment, precisely, you have this nonlinear dramatic phenomenon that we know.

Second, we had no monitoring - second cause, second reason for the difficulty of governance - of the evolution of the overall competitive indicators. The unit labor cost, the external side of the coin, the loss or gains of market share, and the current account surpluses or deficits. That was a mistake. When we negotiated the Maastricht Treaty and it was more or less the view of the global consensus, relying too much on market self-correction, at our table, some of us were saying the market is always wrong, which is true in the short-medium term but which is right in the short term but, of course, wrong in the medium-long term.

But that being said, at that time, we were convinced that the market was always indicating the right price, always providing exactly the best indicators to correct, and particularly, in case any country would have lost competitiveness, the idea was that competition will provide for correction. It was not the case, and I could elaborate on the question why it was not the case and why some countries continue to lose competitiveness.

Third reason, we had no banking union, so the divide of the various European countries between the reliable and high level of creditworthiness countries and the non-reliable, poor level of creditworthiness countries appeared to be creating some kind of virtuous circle and vicious circle. Because the banks of the countries that were not credible, where it had creditworthiness which was considerably aggravated by the fact that the backstop of these banks was precisely a non-credible country. We had a virtuous circle in the other part of the euro area where you had a solid public signature, which was backing the banks and helping the banks to have an even better signature.

All taken into account, these three reasons: no respect of the Stability and Growth Pact, no pillar to monitor competitiveness, and high level of correlation between the creditworthiness of the banks and the creditworthiness of the country, which was observed everywhere in the world - in the UK, in the U.S - but in Europe it was contributing much more to widening of the distance between the good signature and the bad signature.

I would mention two other reasons why we had problems in the euro area. Some countries had big problems. But I mentioned, *en passant*, these are not issues for the euro area alone. These are issues for the 28 members of the European Union. One is the non-achievement of the single market, particularly in the domain of services. The other one is the absence of sufficient structural reforms. In both cases, it is monitored at the level of the EU 28, not at the level of the EA - Euro Area - 18 today. But of course, for the Euro Area, it's particularly grave not to have an appropriately functioning single economy with all flexibility that you would expect in a single economy, a single market with a single currency.

Now, if I look at what has been done in the crisis, we have a reinforced Stability and Growth Pact. And I am, I have to say, amazed in some respect that after the big difficulty that we had, some are arguing again that this is too tight a jacket. We paid a very high price for having considered in the recent period that it was too tight a jacket. But I'll let you reflect on that.

Second, we have now a pillar for monitoring competitiveness, which is called the Macroeconomic Imbalance Procedure, MIP. I recommend you to have in mind that the MIP is as important as the SGP is. I would say that also to the Commission, because the Commission is responsible both for SGP and MIP. But the (earlier) absence of MIP explains very well why Ireland and Spain had problems. The absence of respect of the SGP does not explain Ireland and Spain. It explains Portugal. It explains Greece. Again, we have now completed a more comprehensive handling of economic and fiscal governance in the euro area with the MIP and the SGP.

We have a banking union which is in the making and is certainly very, very important, to avoid this high level of correlation I mentioned between the banks and the sovereign, which, again, contributed to aggravate the situation. But that doesn't mean of course that with banking union, the banks are totally decoupled from the sovereign. Of course, the correct handling of governance at the level of the sovereign, both individually and collectively in the Commission and the Council remains absolutely of the essence.

Now, you will tell me all this is good. So you have better governance, better technical governance, but where are we going on that basis? I really believe that we are presently underestimating the kind of political union that is embedded in the SGP and the MIP and also, probably in banking union. It goes very far. We are the heart of the decisions that are taken by any government when we are speaking of budget policy. We are necessarily dealing with the parliaments, the national parliaments. The national parliaments themselves and democracy was born out of the representation for taxation. I could see that on the license plates. It's not mentioned here, it is taxation without representation. This is taxation without representation.

But we all know that not only the independence of the U.S. but also democracy in the UK was born out the representation to accept taxation or not.

You have to correct that, but that is a recommendation which goes very, very far because we are at the heart, not only of the responsibility of the government, perhaps of the parliament too, but also of the social partners because if the idea is that you have to freeze the remuneration, it goes far. Still it is necessary and still it is the normal consequence of the functioning of the institution, now that we have drawn the lessons from the crisis.

So my understanding is that at a certain moment, we will have to give an additional democratic legitimacy to this very, very important new pillar of governance. I must confess that looking at the European institutions, I don't see where else other than the European Parliament, which is elected by universal suffrage, I don't see too well where you could find another institution which could give additional democratic legitimacy in close connection with the parliament of the country in question.

So I'll let you meditate a little bit on this important element: how to give more democratic legitimacy to an economic and fiscal union which has been formidably reinforced by the crisis itself , and which has been decided without, it seems to me, our public opinion recognizing that it was going extremely far with very good reasons obviously. But perhaps at a certain moment, particularly when there is a disagreement between the European institutions, namely the Commission and the Council, and the particular country, giving the arbitrage to the democratic institution which is the European Parliament in close connection with the national parliament, it seems to me as something quite natural.

Now, I would like to conclude. So let me only tell you that what I read very often regarding the popularity of Europe and of the European institutions seems to me a little bit overdone. I don't of course deny for one second that in all our countries we have an increased uneasiness of our fellow citizens. That this increased uneasiness is particularly visible in the deterioration of the overall confidence level for the European institutions, for the European concept in general.

But we have to be aware of an optical illusion, because communication concentrates very much on this element in Europe . I see a more generalized problem in the advanced economies, which we can observe everywhere, so I will not dwell too much on the Tea Party in the U.S. compared with the extremists in the U.K., compared with the extremists in France - only to quote three countries - but we can see that we have a number of fellow citizens that are extremely unhappy with their situation both in the euro area as well as in the U.S. and UK.

I think we have explanations for that because it seems to me that it is associated with all the difficulties I was mentioning for the advanced economies in general. Competition coming from India and China to oversimplify, ageing of the population which creates additional problems and the advances of science and technology that are also obliging our fellow citizens to adapt themselves in a way which they consider, perhaps rightly so, too rapid, too dramatically rapid. But that's another story. I will concentrate on Europe now.

The European Parliament, last poll: trust, 37 percent; no trust, 48 percent; don't know, 15. Commission, trust, 32%; no trust, 46;% don't know, 22.% Now, compare with the national institutions themselves. After all, you have to control that. What happens with the national institutions? European Parliament is bashed, okay. What about national parliaments? National parliaments, instead of 37% , 28 % trust. Instead of no trust, 48% for the European parliament, no trust for the national parliament is 65%, so there is much more rejection of the national institutions in the parliament story. Now, the Commission, perhaps we can compare. It's flattering for the both I would say, the government, the national governments and the Commission. Instead of 32% trust for Commission, it's 27% for the national government. Instead of no trust, 46% for the Commission, it is 68 % for the national governments. Now, if I would take the U.S. Congress, I'm told that the trust in the Congress is around 20 percent. It's a phenomenon which is generalized, which is worse, at least in Europe, for the national institutions than for the European institutions. I don't draw from that anything , but let's be fully conscious that our fellow citizens are not happy at all. They are calling, of course, for a better situation which is very demanding on the leaders, whoever they are, and on the institutions, whatever they are. That is true again for absolutely all of us in the long run.

I spoke in the introduction of my exposition on the resilience of Europe. The resilience, a main concept, but in the long run we will all be judged by the criteria of prosperity, job creation, and goals. I put job creation first because I trust that it is the main concern that is in our society. I would say on both sides of the Atlantic in some respect, and that we have to be sure that we are combating as effectively and efficiently as possible.