

THE FUTURE OF THE EURO AREA

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When we look at the future of the euro-area, we tend to extrapolate the present situation, while focusing on the imperfections of the Union in order to correct them. This is precisely what you are going to do this morning.

In this spirit and as an introduction, I would like to offer you my own views from three standpoints.

1) Strengthen the banking Union.

Two encouraging spots :

- the creation of a true common rule book ;
- the institution of a single supervisory mechanism.

But, the job must be completed on two important fronts :

- in terms of bank resolution, the Union needs a meaningful backstop for the Resolution Fund, as well a Common Deposit Insurance Scheme;
- we also need to eliminate the present regulatory ring fencing of liquidity and capital which is hindering the operation of true cross border banking groups in the Union.

2) Reflect intelligently on what could be an acceptable “fiscal union”.

There are two self-reinforcing approaches here :

- make sure that members are achieving meaningful budgetary adjustments at home (peripheral countries have already made significant progress in this field);
- create some adequate and limited form of central fiscal stabilization in case of asymmetrical shocks.

But here we must be careful: the Union is NOT a Union in which fiscal transfers are supposed to equalize automatically all the evolutions of revenue discrepancies in the zone. This has never been the Maastricht concept nor should it be introduced in the backdoor. Nevertheless, some limited forms of fiscal stabilizers can and should be conceived in order to deal with some shocks and to take into account negative externalities produced by the existence of the Union. In this regard, one could think of a somewhat bigger budget that seems appropriate if only because of the necessary upcoming political evolutions of the Union.

3) Restore a coherent Monetary Union in macro-economic terms.

When you look at the macro-economic picture of the euro area, you are struck by three things :

- the fact that economic heterogeneities do not come only from cyclical events (or policy-mistakes) but, in large part, from structural factors(productive specializations usually increase among countries participating in a monetary union, with consequences on relative productivity rates) ;

- the unsustainable global imbalance: while, over the last three years, all the peripheral countries (contrary to France) have swung from current account deficits (sometimes huge in terms of GDP) to balance or even surplus, the "Northern" parts have been running excessive surpluses (Germany:8,7%of GDP , Netherland 10%) that are the manifestation of a "fundamental disequilibrium "and entail negative externalities for others.

In a way, the remarkable adjustment realized by the "weaker" countries through a containment of their domestic demand in the face of still high unemployment, has been annihilated - in global terms - by the explosion of surpluses (one has calculated that in terms of "real equilibrium exchange rates", Germany has an undervalued rate of 20% versus the average of the Union the correction of which would imply arithmetically a 2% annual inflation rate in Germany and a 0% inflation in the other countries for a decade). This can, and must, be dealt with by adequate measures and not only by relying on lasting reductions of revenues and costs by those countries that have achieved external balance. Time has come to start applying symmetrical adjustments in deep surplus countries.

The third point is that savings surpluses don't sufficiently go to the needy European countries but are channeled outside of the Union (by contrast, in the USA, it is the private market capital flows that take care of some 80% of the adjustment in case of asymmetrical shocks, while fiscal federal transfers are only very limited, less than 20%). This is what the so-called "Capital Market Union" should be concretely working on.... Useful proposals have been outlined, in this regard, but have not been considered.

More generally, a coordination of economic policies is urgently called for : one cannot continue to turn a blind eye to externalities stemming from some policy actions – or inactions -. Adjustment has to be more equitably divided among internal devaluations but also reevaluations.

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