Opening address

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Obviously, the title of our workshop *Toward a Genuine Economic and Monetary Union,* implies that Economic and Monetary Union (EMU) is not genuine yet. But despite all its deficiencies, let us not forget that EMU and the euro are major achievements. For its member states, EMU has anchored price stability and increased cross-border trade and financial integration. Even during the financial crisis, the number of countries sharing the euro increased to 19, and is set to grow further. For the European Union as a whole, the single currency is a symbol of a peaceful Europe, a keystone of economic integration and political unity. And for the world, the euro has become a major player in the international monetary system and the global economy.

Yet, during the global financial crisis, EMU was seriously put to the test. The fact that the so-called "sovereign" debt crisis (which incidentally had also been caused by private debt accumulation) occurred in Europe and not in other regions with even higher debt levels is certainly related to the incomplete institutional setting of EMU. While the monetary part of EMU was fully implemented in 1999, the economic counterpart is still an unfinished business.

But how can we ensure the smooth functioning of EMU? The recently published *Five Presidents' report* on *Completing Europe's Economic and Monetary Union* tries to address this question. The five presidents in question are those of the European Commission, the European Council, the Eurogroup, the European Central Bank and the European Parliament. Their proposals rest on *four pillars*: First, an *Economic Union* that promotes convergence, prosperity and social cohesion; second, a *Financial Union* that integrates banking and capital markets regulation; third, a *Fiscal Union* that guarantees sound public households; and fourth, a *Political Union* that strengthens democratic accountability, legitimacy and institution building.

As an aside, let me point out that the structure of the *Five Presidents' report* varies slightly from that of the preceding Four Presidents' report, published during the height of the crisis in 2012 by the same institutions except for the European Parliament. In that report, the four pillars of genuine EMU were listed in the following order: a Banking Union followed by a Fiscal, an Economic and a Political Union. There may be political economy considerations behind the fact that the Five

Presidents prioritize Economic Union, as buoyant economic activity facilitates the implementation of ambitious reforms. Apparently, the renewed dip in economic activity observable since 2013 has hampered European citizens' appetite for further deepening of EMU and indeed strengthened disintegrative forces across the EU. Moreover, the progress made in recent years in the fields of Banking and Fiscal Union may justify their "downgrading" in the current report.

This workshop builds on our conviction that such a comprehensive framework deserves academic scrutiny from various disciplines and a broad public debate. Let me just make some personal comments on the issues at stake.

I would like to start with some reflection on Monetary Union – a fifth pillar the Five Presidents implicitly seem to take for granted. In the run-up to the crisis, the question was raised whether a one-size monetary policy can fit it all, as some countries were enjoying an economic boom while others were still struggling against economic contraction. This uniformity of monetary policy should not be overemphasized at the current juncture, however, as almost all euro area economies still have a negative output gap. But sooner or later, some countries will be forced to adopt fiscal, macroprudential or structural policies that counteract a monetary policy stance that might be inappropriate for them in particular, while the ECB can and must only target the euro area aggregate with its monetary policy.

Currently, the Eurosystem's monetary policy helps improve the otherwise lackluster outlook for economic growth and price stability in the euro area. Low or even negative interest rates favor spending over saving. Asset purchases (or quantitative easing) help fix the monetary transmission mechanism. The provision of long-term liquidity to the banking sector supports lending to the private sector. Forward guidance affects long-run interest rate and inflation expectations.

Let us not forget that the ECB's readiness to do "whatever it takes to preserve the euro," as announced in mid-2012, was undoubtedly the decisive element in re-establishing confidence in sovereign bond markets – a precondition for recovery. Additionally, the ECB is the key player in the Single Supervisory Mechanism (SSM), a core element of Banking Union. Moreover, it is one of the institutions involved in the assistance programs for Member States under financial stress. All this made some commentators fear that the ECB, as "the only game in town," might be stretching beyond its mandate. More importantly, however, it underlines the need for other or new institutions to step in and relieve the ECB from some of its responsibility. Actually, this is the central message of the Five Presidents' Report.

The rationale behind a genuine EMU as a complement to the ECB's monetary policy comes from the *Optimal Currency Area (OCA)* theory, which states that within a monetary union, the lost mechanism of exchange rate adjustments must be replaced by that of labor and capital adjustment if countries are affected by asymmetric shocks. Hence, the justification of structural reforms in labor and product markets. They should increase the flexibility of wages and prices while taking into account the autonomy and responsibility of social partners.

Another element to improve the resilience of EMU would be stronger business cycle synchronization through economic and financial integration; but here the evidence is sobering. Yet, while the OCA theory concentrates on asymmetric external shocks, what seems to matter more are really asymmetric trends. This is to say that since the introduction of the euro, member states have systematically built up external imbalances as a result of unsustainable debt accumulation and asset bubbles.

Here comes in another element of the OCA theory: the role of risk-sharing mechanisms. Given the lack of fiscal risk-sharing, however, this role has been more or less explicitly delegated to financial markets. Unfortunately, however, financial market participants insufficiently understood the risks they were taking. The rest of the story is well known: A dramatic stop of private financing flows required economies under stress to quickly adjust their external imbalances via improved competitiveness at the cost of internal disequilibria, notably high unemployment. The negative spillovers have been felt all over the euro area during the double dip recession, albeit at different degrees.

What can we learn from this crisis? Apart from market-based risk-sharing mechanisms, EMU needs a fiscal framework that combines risk reduction and risk-sharing, in other words: discipline and solidarity. While the ultimate shape of a genuine EMU will remain a matter of political preferences, it seems essential that some pooling of sovereignty takes place to ensure (1) sound national fiscal policies, (2) the joint provision of common public goods, (3) a credible backstop to break the vicious circle of weak sovereigns and banks, and (4) a shared emission of safe securities.

As a matter of fact our institutions will not become perfect, and their improvement is a permanent process of trial and error. Disagreement is a natural human feature, and concerns will be understandable when put into context; therefore, our workshop openly addressed skepticism as well. We believe that national central banks like the OeNB have a responsibility to encourage debate that goes beyond the deliberations of policymakers.

Not every aspect of the EMU reform project discussed during the workshop may seem realistic for the immediate future. In this context, I would like to highlight a few words about the timing and sequencing of this very important reform project. In particular, I would like to caution against those voices arguing that EMU needs to be fundamentally re-built, or even re-established from scratch, within the next two years and arguing that „otherwise it will fail“. This argumentation, in my view, is extremely dangerous as it puts our already substantial achievements of the past years at stake. Offering a contrasting perspective, I would like to recall Sir Karl Popper’s piecemeal approach, and strongly argue for a step-by-step strategy. Fortunately, also the *Five Presidents’ report* prudently envisages two different stages toward completing EMU. In a first step, changes would build on existing instruments and make the best possible use of the existing treaties, thus increasing their probability of being implemented in practice. Only in a second stage, in a rather long-term perspective, the *Five Presidents' report* proposes measures of a more far-reaching nature, requiring fundamental treaty changes. We should keep in mind that these days the political feasibility of substantial changes to the Lisbon Treaty seems rather limited, as it is not even clear how many members the EU might comprise in two years from now and as every single EU Member State may veto a suggested Treaty change. Thus, unrealistic reform proposals cannot be seen as constructive contributions to the project but are rather politically and psychologically dangerous.

To put it in the words of ECB Board Member Benoît Cœuré: "The EU is a union of democracies and it should be more trustful in the power of democracy to produce the solutions that will address the deep causes of the crisis." Monetary integration is a means to the ends enshrined in Article 3 of the Treaty, which states that the European Union "shall promote economic, social and territorial cohesion." Together, we can contribute to smart, inclusive and sustainable growth in a Europe where the single currency becomes a true common currency.