The Mayekawa Lecture: The Euro Area Economic, Fiscal and Financial Governance: Difficulties and Successes in the Past–Present Challenges–Future Steps

by Jean-Claude Trichet

I. Introduction

It is a great honor and a great privilege to be invited to hold the Mayekawa Lecture here in Bank of Japan (BOJ).

Since the very beginning of my career, I was lucky enough to know personally, to work with and to appreciate the wisdom of six Governors of BOJ. I have had this privilege with Governors Yasushi Mieno, Yasuo Matsushita, Masaru Hayami, Toshihiko Fukui, Masaaki Shirakawa and Haruhiko Kuroda. Whether I was myself deputy secretary of the Treasury, Governor of Banque de France (BdF) or president of the European Central Bank (ECB), I was always struck by the convergence of our views in very difficult and demanding circumstances, by the fact that our diagnosis and recommendations were often close due to similar features of our respective cultures, including the trust that a solid and pertinent diagnosis by a public authority like the central bank could really make a difference.

It is having in mind this long-term cooperation and joint inspiration with yourself, Governor Kuroda, with your predecessor, Governor Shirakawa and former dear Governors of BOJ that I am starting this Lecture.

When reading academic works, published observations, articles signed by specialized journalists as well as articles for a large public, coming particularly from non-European countries, there is often the remark that the euro had been a disappointment. The single currency economic performance is supposed to be very poor, particularly in comparison with the United States (U.S.). The impact of Economic and Monetary Union (EMU) on public opinion in member countries is deemed negative, dividing countries and eroding confidence in the European project.

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I think 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 negative bias against the single currency has been observed since the inception of the euro.

I will claim, on the contrary, that the euro is a historic success. I must mention, to be fully transparent, 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, head of the Cabinet office of Edouard Balladur, Minister of Finance, and then Undersecretary of the French Treasury (1983–1993), period when France decided to pursue a bipartisan economic policy of "competitive disinflation" designed, in particular, to reinforce European economic and monetary integration. As Governor of the independent BdF, 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 ECB. From November 1, 2003 up to the end of October 2011, I was President of the ECB.

So, from 1979 to 2011, I worked during 33 years 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 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 view of the period over which the single currency was envisaged and implemented would start with the Werner Report (Werner [1970]) which proposed the concept of EMU until today (namely 2019). This represents a period of 49 years—around half a century.

I will make the following four points:

1. Contrary to many negative predictions, the euro, as a currency, is a remarkable success in terms of **credibility, stability and resilience.** This resilience is due, in particular, to a large popular support.
2. The euro area is more of a success in terms of real growth measured during the period starting from its inception until today. But the appreciation must be more nuanced as regards nominal and real convergence inside the single currency area.
3. In a medium- and long-term perspective, EMU calls for further significant reinforcing its economic, fiscal and financial governance.
4. Drawing a number of lessons from the crisis, the ECB actively participated in what I call "conceptual convergence" of policy making in advanced economies' central banks.

Overall, the success of the euro and of the euro area in terms of **credibility, resilience, flexibility, 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. To consolidate this long-term success, a lot of hard work remains to be done as is always the case when a bold historic endeavor is in the making. The single market with a single currency of the U.S. was not achieved in a short span of time. Neither in 20 years, nor even in 40 years! From the Coinage Act of 1792 to the Federal Reserve Act of 1913, there is a maturing process of around 120 years. And since the issuance of the first federal note in 1914 and today, an additional period of 105 years.

II. A Success in Terms of Currency Credibility, Stability and Resilience

A. Credibility

In January 1999, the euro started from scratch. The exchange rate was 1.17 U.S. 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 Deutsche mark, 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 delivering this Lecture, the euro-dollar exchange rate is approximately at its entry level (1.12 U.S. dollar today versus 1.17 at its inception). 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 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, it represents 23% of the "international debt outstanding" (62% for the dollar, 2.4% for the yen).[1]

In terms of "*global payment currency*," it represents 35.7%, approximately ten times the percentage for the yen and not so far from the dollar (39.9%).

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

The euro is the unchallengeable second most important international currency. I would only add that 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.

B. Stability

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%,

1. See "The international role of the euro, interim report, June 2018" (ECB).

quickly clarified in 2003 as "less than 2% but close to 2% in the medium run."

Since its inception from 1999 up to 2018, 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.

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- and 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%. 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.

C. Resilience

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 respect for its boldness but incapable to sustain the difficulties of hard times. In this early 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 the euro area.

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

1. First, refusal to fully apply the rules of the Stability and Growth Pact (SGP) before the crisis. Important in particular are the responsibilities of France and Germany, under the presidency of Italy, in the years 2003–2004, where they refused that the provisions of the SGP be applied to them;
2. 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;
3. Third, absence of banking union;
4. Fourth, absence of a specific instrument to fight against speculation (no European Stability Mechanism (ESM) at the beginning of the crisis);
5. Fifth, poor implementation of needed structural reforms all over the euro area;
6. 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 for the whole single currency area. The "Economic Union" had *lacunae* in its design and was poorly implemented before the crisis. All taken together, the economic, fiscal and financial governance of the whole euro area was suboptimal.

That being said, many highly pessimistic 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 the 15 countries members of the euro area at the time of the Lehman Brothers bankruptcy, 5 (namely one third) had very serious 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 market participants (for instance Greece, Portugal, etc.) and the best ones (Germany, Netherlands, Austria, etc.). 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 be flexible, 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 SGP was reinforced, the Fiscal Stability Treaty was signed and ratified, the Macroeconomic Imbalance Procedure (MIP) was set up, Banking Union was created and the European Stability Mechanism Treaty was signed and ratified. All of the first four weaknesses mentioned earlier were addressed. 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 and to prove a remarkable resilience.

To make a long story short, let me mention the fact that 15 countries were members of the single currency area on September 15, 2008, the very day of the bankruptcy of Lehman Brothers. 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. Is there a better refutation of the fragility of the area than a significant expansion in a period of major financial crisis?

D. Popular Support

The conventional wisdom was, and still is, that popular support is dramatically lacking for the European integration project. This belief was reinforced by the unexpected success of a political populist persuasion in the United Kingdom (U.K.) and in the U.S. It appeared quite natural that a political wave characterized by nationalism, protectionism and xenophobia would be present in continental Europe and would have also a strong anti-European Union (EU) component, as was the case in the U.K. for instance.

It is unchallengeable that the frustration of public opinion, generalized in the advanced economies, is also present in the EU 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 and European Parliament).

The surveys "Eurobarometer" are particularly interesting.[2] 42% of citizens members of the EU "tend to trust the European Union," significantly more than those who "tend to trust their national governments or parliaments" (35%). This is even more impressive when comparing the percentage of citizens who "tend not to trust": 48% for EU compared to 59% for national governments and 58% for national parliaments.

Comparisons are also remarkable when directly comparing confidence in the European parliament with confidence in national parliaments: 48% versus 35% for "confidence" and, overall, 39% versus 58% for "no confidence." This means a difference of +9% for the European parliament and −23% for the national parliaments. The same difference is observed as regards comparison between the European Commission and national governments: 43% versus 35% for "confidence" and 39% versus 59% for "no confidence," namely +4% for the Commission and −24% for national governments.

Finally, it is equally noteworthy that the support to the EU is presently higher than during all the period starting with the great financial crisis. The bottom line is that nothing is satisfactory: our fellow citizens are giving a weak confidence level to all institutions whether national or European. Still the confidence *vis-à-vis* Europe and its institutions is significantly higher than confidence in national institutions.

As regards the euro, the support given by the European citizens inside the euro area to the single currency is high and much higher than the perception of global observers. 75% 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 the question is pertinent is confirmed by the response of the UK citizens (28% approve, 59% disapprove). The present proportion of 75% in the euro area member countries is the highest in the survey since its inception in 2004.

One of the most frequent errors made by observers outside the euro area was that the euro was rejected by public opinion. I was often confronted to the view that the Greeks were massively in favor of leaving the euro to avoid the economic adjustment ("austerity") and that the Germans would massively take advantage of the crisis to get back to their previous national currency, the Deutsche mark. Nothing could be further from the truth! The Greeks were massively in favor of preserving their euro-participation (67% are approving the previous sentence on the euro). And the Germans were (and are) strongly in favor of the euro (81% are approving that sentence in the last survey).

As said before, this popular support, so far away from the conventional wisdom outside Europe explains largely the remarkable resilience of the euro and of the euro area.

2. See "Standard Eurobarometer 90" (European Commission).

III. The Euro and the Euro Area Are Posting Significant Real Growth in Comparison with Other Advanced Economies, Even If Real Convergence between Member Countries Is Insufficient

A. Real Economic Growth

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 strong 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 supposed to be indisputable real economy failure!

Comparing the euro area to the U.S., the economic 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 U.S. which benefits from a yearly positive demographic growth differential of around +0.7%. Second, in the most recent period, real growth in the euro area was hampered not only by contagion of the global financial crisis in 2007–2008 but also by the sovereign risk crisis in 2010–2013, the euro area being at its epicenter. The recovery started in the U.S. mid-2009 while the sustained 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 in that period. Second, it is a period sufficiently long to cover more than an economic cycle. Third, the starting point and the endpoint are sufficiently far from the start of the global financial crisis for the period not to be too influenced by the various steps of the crisis on the real economy of the U.S. and of the euro area.

That being said, where do we stand?

To be sure that my comparison between the U.S. and the euro area would be as sure and correct as possible, I will rely upon International Monetary Fund (IMF) and World Bank figures. According to the IMF, the 1999 gross domestic product (GDP) per capita of the euro area was around 22,300 dollars compared to 34,500 dollars in the U.S. According to current projections, the respective GDP per capita in 2018 would be around 40,200 dollars and 62,500 dollars. The dollars are current dollars over the period.

These IMF figures suggest multiplication of the GDP per capita by 1.80 in the euro area and 1.81 in the U.S. The difference is very modest and does not suggest a significant advantage for the U.S. In any case, it does not confirm at all the growth failure of the euro area that is often part of the conventional wisdom.

These results are significantly depending on the chosen starting year. The period 1998–2018 is more favorable to the U.S., while the period 2000–2018 is more at the advantage of the euro area. The bottom line is that there are no IMF figures that would suggest that the growth per capita of the euro area as a whole is significantly different from the U.S. growth per capita since the setting up of the euro.

Data 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) are contributing positively to growth of the whole area despite the fact that they are small economies. The reason is that they started from lower levels in terms of GDP per capita. But this cannot explain the significant difference I am stressing between perception and reality of the euro area growth per capita.

The results from IMF data are confirmed by the World Bank data on real growth per capita in the euro area and in the U.S. To make a long story short, World Bank data on real growth per capita from 1999 up to 2017 are the following: annual growth of 1.1% in the euro area and 1.2% in the U.S., namely the same order of magnitude on both sides of the Atlantic.

It is also suggested from time to time that countries outside the euro area did better, and even much better, than countries inside the single currency, since its inception. It is always possible to find a very bright European economy out of the euro area: Norway or Switzerland, for instance. But I had the curiosity to compare the euro area with the U.K. over the first 20 years of the euro. Contrary to common belief, the IMF data are giving an advantage to the euro area *vis-à-vis* the U.K. in terms of growth of GDP per capita, whatever the starting year is. If we trust the IMF figures, the catching up process of the euro area *vis-à-vis* the U.K. is visible. At the inception of the euro (1999), the GDP per capita of the euro area was around 21.5% below the U.K. level. In 2018, the IMF projection put the euro area around 5% below the U.K. level.

This overall encouraging situation of the euro area in terms of real growth per capita does not mean that the Europeans can rest on their laurels. The GDP per capita of the euro area remains significantly lower than in the U.S. (36% lower) 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 still much too high. Europe and the euro area are not innovative and creative as they should and as the U.S.—and also China—are in terms of High-Tech and IT new businesses. Also in the domain of education and universities of excellence at a global level, the euro area is at a disadvantage in comparison with both the U.S. and the U.K.

B. Economic Convergence between Member States Must Make Further Significant Progress

If growth per capita in the euro area is comparable to the growth per capita in the U.S. since the inception of the euro, another dimension of the euro area must be examined, namely convergence between members countries in terms of nominal evolution of inflation and interest rates, of synchronization of the timing of business and financial cycles, and of real convergence in terms of growth and standard of living. From this stand point, according to Franks *et al.* (2018), the situation of the euro area is nuanced and depends on the convergence criteria analyzed.

1. Nominal convergence of inflation and interest rates took place in the period of convergence before the setting up of the euro. There has been a significant reversal during the financial crisis, particularly as regards interest rates at the time of the sovereign crisis, but nominal convergence has been significantly reestablished since.
2. As regards business cycles, the synchronization of the timing has improved but the amplitude of those cycles has diverged. As regards the timing of financial cycles, they have largely diverged during the pre-crisis boom period in several countries but have since been reestablished. As noted with the business cycles, the amplitude of financial cycles has become more uneven.
3. It is as regards the real economic convergence of growth and standard of living that the results are most contrasted. Real convergence has not really occurred among the original 12 euro members (including Greece which entered in 2001). In that constituency, GDP growth and productivity growth have not reduced income disparities between high and low revenue per capita countries. In contrast, there has been an impressive convergence for those 7 countries that have joined the euro after it was set up. This puts into question the pertinence of the early economic governance of the euro area and the effectiveness of the implementation of this governance in those early-entry countries which didn't converge.
4. If there is no doubt that the single currency offers additional new economic opportunities and additional new potential for growth to all member countries, it clearly doesn't mean that belonging to a single currency is a guarantee to attaining the highest level GDP per capita. As the U.S. example suggests strongly, a State's economic success still depends heavily on the quality of the economic management, on the progress made in terms of productivity and on the level of investment in that State. For instance the State of Mississippi has not the same standard of living as Massachusetts (respectively 33,558 dollars, 71,456 dollars in 2018, according to IMF figures), even if the U.S. has a single currency, together with an achieved political federation, a federal budget and a functioning single capital market. By the way, according to 2017 IMF figures, the Portuguese or the Greek standards of living (23,116 dollars, 23,027 dollars, respectively) are displaying the same gap *vis-à-vis* Germany (46,747 dollars) as Mississippi *vis-à-vis* Massachusetts. This is only comparing average standards of living. A full-fledged comparison, taking also into account the level of unemployment, would accentuate the differences observed in Europe because unemployment is comparatively high in Greece and relatively low in Mississippi.
5. Still there is an important issue in inequalities in Europe, inside each country and between member countries (like, in the U.S., within and between States). Economic convergence inside the euro area must be improved, being understood that it is convergence towards full employment with the highest possible GDP per capita which is the goal. Reinforcing convergence inside the euro area is of the essence and calls for consolidated and strengthened economic, fiscal and financial governance of that area.

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, give all their chances to member countries and to the area as a whole to catch up in terms of job creation and standard of living.

IV. We Have to Strengthen the Economic, Fiscal and Financial Governance of the Euro Area

The success of the euro, as a currency, and of the euro area in terms of **credibility, resilience, flexibility, 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 long-term historic endeavor is necessarily history in the making. I see many avenues for European progress in the years to come. President Macron listed recently major multidimensional reforms for the medium-term future of EU.

First, indeed, one should not forget that EU has many other dimensions than the economic and monetary ones. Culture, 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 are 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: for instance, a "common defense and security policy" is approved by 76% against 18%; a "common foreign policy" is approved by 65% against 26%.

Second, in the specific domain of EMU, I see six 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. Rapidly achieve what has already been decided as regards Banking Union, both in its deposit guarantee and single resolution dimensions. It is also necessary to eliminate the prudential obstacles that are still hampering crossborders banking restructuring. There is unfortunately neither in the EU nor in the euro area a genuine single market of banking services. The European banking sector is lagging behind the U.S. banking sector. I would compare this unfortunate situation to what we are observing in the domain of digital technologies and digital platforms. As a matter of fact, the lack of significant banking restructuring, both domestic and cross border, explains largely the significant differences observed on both sides of the Atlantic in terms of solidity and profitability.
2. Apply seriously and rigorously the provisions of the two main pillars of economic and fiscal governance: the SGP—reinforced by the "fiscal compact"—and the MIP. I think personally that MIP is as important as SGP: it

is of the essence in a single currency area to correct the persistent divergences between national competitiveness and national and external imbalances. It is perhaps regrettable from that standpoint that too many criteria are examined by the Commission when monitoring MIP. It contributes to neglect one absolutely essential element: in a single currency area where monetary realignment is excluded, persistent growing divergences between national cost competitiveness cannot be durably tolerated. If maintained, they will trigger either accumulation of permanent large-scale unemployment or abrupt and sharp macroeconomic corrections that would be necessary to redress competitiveness of the country concerned, but are always very painful for the disadvantaged fellow citizens, particularly the young.

3. Improve the decision making inside the ESM with the introduction of a qualified majority instead of unanimity as is the case presently. It is also to be noted that the importance and the size of the ESM are often underestimated: this institution was given a callable capital of 624 billion euros on top of its paid in capital of 81 billion euros. With a subscribed capital of 705 billion euros, the ESM is the international institution which possesses the highest level of subscribed capital.
4. Design a Minister of Economy of the euro area who would preside over the Euro Group of Ministers of Finance and would concentrate exclusively on the economic, financial and fiscal governance of the euro area, without being simultaneously Minister of Finance of a particular country. I made this proposal already in 2011 on the occasion of my Charlemagne prize speech in Aachen (Trichet [2011]). In a medium-term perspective, one could also think of giving the Minister of Economy the responsibility of being Vice President of the Commission upon the model of the High Representative for the Common Foreign and Security Policy who simultaneously chairs the Council of Foreign Ministers and is Vice President of the Commission. Running the economy, budget and finance of the euro area is less and less a legislation function (traditionally given to the Commission) and more and more our executive function exerted with close cooperation of both the Commission and the Council.
5. Reinforce the democratic legitimacy of EMU by 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. It is an ambitious idea for which there is presently no consensus. Still it seems to me that it is necessary to envisage ex ante the possibility of a conflict between the democratic legitimacy of a member country challenging the European recommendations with the backing of its national Parliament on the one hand and the European institutions which were created by a democratic process at the level of Europe as a whole, on the other hand. It is what we have experienced in an acute episode of the Greek crisis. It seems to me that in such a situation, the country challenging the pertinence of the recommendations of the Commission and Council should have the possibility to call for arbitration by the European parliament in a euro area format. The latter would have the

last word, after close consultation with the National parliament of the country concerned. I made this proposal in 2013 (Trichet [2013]).

6. Setting up a budget of the euro area. Such a budget could have several different functions.

First, it could finance public spendings that are national today and would be federal tomorrow. Several ideas have been proposed in this respect, for instance financing at the level of the euro area part of the unemployment insurance expenses. It is also possible to consider expenses in defense, security, border control and in that case, the budget could cover such federal expenses at the level of the EU as a whole and not only of the euro area.

Second, the euro area budget could play the role of an anticyclical cushion which would accumulate capital through resources coming from member countries in the favorable episode of the euro area economic cycle in order to utilize it to correct the depressive episode of the cycle. This particular budget function could help counter a possible recession hitting the euro area as a whole, whether associated with the normal economic cycle or triggered by a global shock. Such a mechanism would not normally operate fiscal transfers from country to country and would be neutral over the cycle.

Third, it is possible to set up a budget which would be earmarked to the financing of large pan-European infrastructure investments, technology investment and R&D spendings which would have a pan-European dimension. For this particular function, the budget should be able to finance expenses at the level of the EU and not only the euro area.

Fourth, the budget of the euro area could be designed to help countries badly in need of structural reforms in order to have an economy more flexible and efficient inside the single currency area. This financing would be particularly well adapted for difficult and costly structural reforms, giving positive results after a relatively long delay. The use of such financing could be normally earmarked to euro area countries to the extent that, indeed, the best functioning of the euro area calls for significant reforms in a number of member economies.

The European Council has taken a decision in principle to set up a budget. I understand from statements of Heads and Ministers that this budget will probably materialize by concentrating on the third and fourth possible functions (financing in particular pan-European investments and structural reforms, and therefore helping a better convergence between the member countries).

I would personally advise not to forget the importance of the anticyclical cushion (second possible function) from the economic standpoint, even if we are still far away from a consensus on that matter.

V. The ECB Actively Participated in the Process of Conceptual Convergence of Policy Making in Advanced Economies' Central Banks

Having to cope with the dramatic events occurring in the advanced economies in 2007 and 2008, central banks had the lucidity and the courage to take bold and swift decisions. They were coping with very different economies, with significantly different financial structures, and with diverse historical and cultural backgrounds and conceptual references. One could have expected that, under the pressure of their own economies' idiosyncrasies, the shock of the crisis would have accentuated their differences and given rise to an even more diverse set of decisions, of policy tools and instruments, and of concepts of monetary policy in a selfish, inward-looking mode.

My thesis is that—contrary to what could have been expected and, perhaps, feared—central banks appeared to be practically and theoretically significantly closer when confronted with an economic and financial crisis. This phenomenon was spectacular almost immediately after the Lehman Brothers bankruptcy, with the closest central bank international cooperation ever, including through a multilateral network of swaps lines, which remains a historical accomplishment. This unseen level of close cooperation has also been symbolically illustrated by the coordinated decrease of interest rates that took place on October 8, 2008.

The crisis has also started or accelerated a multidimensional process of convergence of key elements of thinking and making monetary policy. I propose to characterize this phenomenon as a process of "conceptual convergence." It is far from being achieved, if it ever can or should be. But my own perspective suggests that it is an ongoing global process that should call for great attention both from academia and from policymakers.

One obvious dimension of spectacular convergence triggered by the Great Financial Crisis is the adoption, by all central banks of advanced economies, of swift and bold highly non-conventional measures. Targeted purchases of Treasuries, massive purchases of tradable public and private securities on the secondary market, full allotment of liquidity at fixed rates, forward guidance, amongst several other measures were decided in the recent years and are still utilized by central banks. I note, *en passant*, that BOJ was the first to experience both quantitative easing and forward guidance.

I will not elaborate on this first dimension of convergence, which would require a full and lengthy lecture of its own.

But on top of the unconventional monetary policy domain, I see four other dimensions along which, in my view, this phenomenon of "conceptual convergence" is occurring:

A. The best place for locating banking surveillance
B. The prevention of systemic risks
C. The concept of communication through press conferences
D. And last but not least, the definition of price stability

Let us examine more closely these four dimensions.

A. The Best Place for Locating Banking Surveillance

That dimension of conceptual convergence—namely, the need for the central bank to be associated with, or in charge of, banking surveillance and microprudentials—is noteworthy. 15 years ago, there was a profound split among countries and central banks. The U.K. was becoming definitely hostile to central banks being involved in banking surveillance. The euro area was split between countries favoring a deep involvement of the central bank in banking surveillance and countries that were opposing such a concept. The Netherlands, France, and Italy, for example, were of the first persuasion; Germany, Belgium, Finland, of the second one. In several respects, the U.S. seemed to hesitate between the two schools.

Today the landscape is profoundly different. The U.K. got back to its previous long-standing tradition of giving key responsibilities in banking surveillance to the central bank. The euro area has decided to put its new "single surveillance authority" under the ultimate umbrella of the ECB. And the U.S. has reformed banking surveillance in reinforcing the responsibilities of the Federal Reserve System (Fed). I do not suggest that Japan should join the new emerging consensus. But I am impressed by what has happened in other major advanced economies.

B. The Prevention of Systemic Risks

I will stress that all major advanced economies, without exception, consider that their central banks are institutions well placed to play an important role in the prevention of systemic risks and in designing macroprudential policy. Two new institutions, on both sides of the Atlantic, bear witness to this major trend.

The Financial Stability Oversight Council, established by Title 1 of the Dodd-Frank Act signed into law on July 21, 2010, of which the chairman of the Federal Reserve is a voting member. The Federal Reserve Board has an important role to play, to the extent that the primary responsibility of the council is to identify nonbank financial firms that pose a risk and to designate them as systemically risky financial institutions. If this is the case, then the Board of Governors of the Fed subjects the institution concerned to heightened prudential oversight.

The European Systemic Risk Board was set up slightly later, on December 16, 2010. It is chaired by the President of the ECB and is very close to the central bank, to the extent that the ECB is providing the board with analytical, statistical, administrative, and logistical support.

The dramatic unfolding of systemic financial crisis events since 2007–2008 drew new attention to the concepts of systemic risk and of macroprudential action. One of the major lessons drawn from the very beginning of the crisis was that in very highly globalized, integrated, and complex financial systems, microprudential supervision alone can no longer guarantee financial stability. There is therefore an urgent need for macroprudential supervision, aiming at detecting systemic risk and proposing remedial action. The main challenge in systemic risk analysis is to integrate all relevant perspectives on the financial sector to take a holistic view on the system, its dynamics, and its interlinkages.

I think it is remarkable that the financial crisis has not only contributed to creating a large consensus in favor of central banks being significantly involved in banking surveillance and microprudentials but has also helped crystallize an emerging global consensus on the decisive importance of macroprudentials, where central banks are also called to play a pivotal role.

That being said, many implications of the greater role of central banks in these domains can be discussed. The micro and macro surveillance responsibilities should not compromise the ability of central banks to pursue their price stability mandates. One way of ensuring the integrity of monetary policy is to put the new functions very close to the central bank but not necessarily under the direct responsibility of the governing council, monetary policy council, or open market committee.

C. The Concept of Communication through Press Conferences

As regards the improvement in communication through the generalization of press conferences, the convergence took some time since the inception of the ECB which started to organize press conferences from year 1998. It has also been clearly associated with the time of the financial crisis: the first Fed chairperson conferences started in April 2011. It is not surprising that such communication tools have become generalized among major central banks. The absence of immediate real-time explanations, which was the rule in the 1990s, was often triggering several—and sometimes contradictory—interpretations of the decisions of the central banks, creating unwelcome market volatility. It also could happen, fortunately rather exceptionally, that the interpretation of the majority of market participants was not in line with the intention of the monetary policy decision makers.

From that standpoint, it is not surprising that the need for such press conferences appeared necessary from the very beginning in the case of the ECB: there was a need to ensure clarity and absence of ambiguity in the new central bank communication. This was made more complex because, from the inception of the central bank, 11 countries, with their different cultures, public opinions, and languages, were part of the euro area. The need for avoiding diverging messages and interpretations was particularly acute in a central bank issuing a currency for many countries. Finally, it appeared that the real-time communication that was necessary in the euro area since its inception was also found to be extremely useful in the very difficult and demanding financial turbulences triggered by the crisis—even in an established political federation like the U.S. or in centralized nations like Japan and the U.K.

D. The Definition of Price Stability

As regards the definition of price stability, or the level of an inflation target, 15 years ago, only two central banks among the four major central banks of the advanced economies were mentioning a precise definition or target: the ECB and the Bank of England (BOE). Both mentioned the 2% figure on CPI. For the ECB, it was “less than 2%” since its inception in 1998—clarified as “less than 2%, but close to 2%” on May 8, 2003. For the BOE, it was “2% on CPI” since 2003. At that time, neither the U.S. Fed nor the BOJ were signaling their price stability definition or target. Since the decision of the Fed on January 24, 2012 and the statement of the BOJ on April 4, 2013, all four now mention the 2% figure, which has become a global benchmark among all the large advanced economies.

It is important to note that this convergence is recent—2013 for Japan and 2012 for the Fed. Federal Open Market Committee (2012) reads: “The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee judges that inflation at the rate of 2% is most consistent over the longer run with the Federal Reserve’s statutory mandate.”

Moreover, this convergence does not mean that the concepts of monetary policy are identical. Among the four, some central banks are theoretically remaining or becoming inflation targeters, even if the introduction of medium- and long-term considerations has considerably transformed the BOE's initial concept of "pure inflation targeting." Others are explicitly or implicitly mentioning that they do not have an inflation target but a "definition of price stability" (the ECB and, to some extent, the Fed). The crisis, since 2007–2008, has driven central banks to pay considerable attention to growth and job creation and to financial stability, which for some of them, such as the Fed and the BOJ, is a statutory or de facto "dual mandate." At the same time, in my understanding, all consider medium- and long-term price stability as one of the necessary conditions for sustainable growth and financial stability.

This remarkable convergence, which took place in a relatively short span of time, should not be underestimated. Particularly striking is the fact that all central banks concerned have stressed the importance of solidly anchoring inflation expectations over the medium- and long-run. It is precisely this major goal of anchoring inflation expectations that has been the main driver for central banks to indicate precise targets or a precise definition of price stability. The central banks of all major advanced economies, issuing four out of the five currencies of the present weighted currency basket (including now the renminbi) of the Special Drawing Rights (SDRs), are publicly committed to solidly anchoring inflation expectations at or close to 2% in the medium run. They have all confirmed this commitment in statements made public in the present very demanding circumstances. We are now closer to an affirmed inflation global nominal anchor than at any time since the dismantling of the Bretton Woods system.

That being said, it is clear that the central banks of advanced economies have real difficulty to attain their 2% targets and to anchor solidly inflation expectations around 2% in the medium and long term. Many reasons have been listed to explain such a situation, including intensifying global competition, weak demographics, mediocre yearly increase of total factor productivity (TFP) contributing to abnormally weak real growth, technological changes calling for less costly tangible investments, "secular stagnation" as a synthetic concept combining several of the previous factors and, last but not least, anxiety of the labor force in rapidly changing production processes and restructuring in many sectors driving workers and employees to concentrate mainly on preserving their jobs and much less on wages and salaries increases.

From that standpoint, Japan is a case in point amongst major advanced economies. It had, and obviously still has, more difficulty than other major advanced economies to reach its 2% target.

I do not think that anybody can say that BOJ did not do enough in terms of monetary policy audacious decisions. Other factors are, in my eyes, dominant. I see mainly three of them.

Firstly, I will mention the famous "third arrow" of the Japanese economic policy, namely structural reforms. It is clear that those structural reforms have been implemented too hesitantly and too timidly. They happen not to be the game changer that was expected.

Secondly, I will stress demographics which are very weak and are clearly responsible for a large part of the abnormally low real growth that is the medium- and long-term characteristic of the Japanese economy.

Third, last but not least, the generalized absence of significant augmentation of nominal and real wages and salaries, despite the fact that full employment is ensured, is probably the dominant factor. We are there again out of the realm of BOJ monetary policy.

If I were bold enough to give advice to the Japanese public authorities and to the private sector, I would say: "BOJ is not the only game in town! Structural reforms of the economy remain of the essence. And joint efforts made together by enterprises, organized labor and government should be decisive to elevate unit labor costs yearly growth at a level consistent with the 2% target."

VI. Concluding Remarks

In conclusion turning to one of the founding father brain of the EU, I will quote Jean Monnet. I think what he said is not only true for Europe but also true in some respect for the constituency of central banks and for the international community as a whole, in a period of extraordinarily rapid structural changes: "Premature ideas do not exist, one must bide one's time until the right moment comes along."

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