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International policy coordination in the Euro area: Toward an economic and fiscal federation by exception

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1. Introduction

It is a great honor and a great pleasure to be invited to this session at the American Economic Association Meetings in San Diego. The honor and the pleasure are even greater when participating in a panel which is gathering such extraordinary economists and friends under your chairmanship, dear Dominick.

Since mid 2007, the advanced economies have experienced extraordinary challenges and difficult times. We have experienced a succession of shocks that were unseen in the industrialized countries since World War II. I remain convinced that the post Lehman Brothers unfolding of events was potentially even more critical than those which triggered the 1929 crisis. Had the central banks and the public authorities not embarked immediately on prompt and decisive actions, I believe that we would have experienced not only a great recession but a very deep and rapidly unfolding great depression.

It is in this context of the gravest crisis of the advanced economies since World War II that I would like to concentrate on the European issues, and, more particularly, on the Euro area issues.

When people seek a justification for European integration, there is a tendency to look backwards. In particular that European integration has banished the spectra of war from our continent,

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is always stressed. European integration has delivered the longest period of peace and prosperity in European history. This perspective is entirely correct.

But it is also incomplete. There are many more reasons for striving toward "ever closer union" in Europe today than there was in 1945. And these are entirely forward-looking. 65 years ago, the distribution of global GDP was such that Europe had only one role model for its single market: the United States of America. Today, Europe is faced with a new global economy, reconfigured by globalization and by the emerging economies of Asia and Latin America.

This is a world where economies of scale and networks of innovation matter more than ever. By 2016 – that is, very soon – we can expect the Euro area in terms of purchasing power parity to be below the GDP of China whilst still being over and above the GDP of India. Together, these two countries would represent around twice the GDP of the euro area. Over a longer horizon, the entire GDP of the G7 countries will be dwarfed by the rapid development of the systemic emerging economies.

Europe has to cope with a new geo-political landscape very profoundly reshaped by these emerging economies. And Europe is also faced with new global challenges, such as climate change and migration, where effective solutions are possible only at the European and international levels.

In this new global constellation, European integration – both economic and political – is central to achieving prosperity and influence. The challenge is to set the correct path of European integration. Getting this right is essential to realize fully our continent's tremendous potential. Let me therefore lay out a vision for the Europe of tomorrow.

The creation of Europe's economic and monetary union is unique in the history of sovereign states (Mundell, 1961, 1969; Feldstein, 1997). The Euro area constitutes a "society of states" of a completely new type. We have created progressively a concept which goes far beyond the Westphalian concept of sovereign states. Like individuals in a society, Euro area countries are both independent and interdependent. They can affect each other both positively and negatively. Good governance requires that both individual member states and the institutions of the EU fulfill their responsibilities.

We have observed the functioning of the Euro area for 13 years. As all advanced economies, we have experienced the shock of the crisis over the last five years. It is time now to draw lessons from these first years.

The acronym EMU – Economic and Monetary Union – is made of three letters E, M and U which means that we must have, and have indeed, two unions: a monetary union MU, and an economic union EU.

2. Achievements of the monetary union

I will not expand too much on the successes of monetary union. Let me only mention the following elements:

- *First*, the new currency, starting from scratch, has maintained price stability for an entire continent of seventeen countries and 333 million people. The average yearly inflation over the first 13 years has been 2.03%.
- *Second*, savers and market participants are trusting the Euro to keep its domestic value as well in the future. The inflation expectations that one can draw from the financial markets, when taking into account risk premia, are, for the next 10 years, around 1.9%–2%, in line with the definition of price stability of the ECB.