Europe at the crossroads

Joint article by Jens Weidmann, President of the Deutsche Bundesbank and Francois Villeroy de Galhau, Governor of Banque de France

Today, Europe is at the crossroads. The debt crisis is still not completely over, and unemployment is high in many member states. The rise of terrorism and the huge influx of refugees have to be addressed. In both France and Germany, some may have the feeling that, on each of these issues, European solidarity has been notably absent. Others go so far as to fundamentally call into question the European project, with nationalist tendencies appearing to rise up in many member states. However, for both of us as committed Europeans, Europe's future cannot be built on renationalisation but on strengthening its foundations. Europeans share strong values, a fair social model, and a solid currency. These are assets we should build on.

The sovereign debt crisis, however, has rattled confidence in the European monetary union (EMU). Despite all the various measures taken to improve the stability of EMU, important weaknesses in its structural framework remain. What is more, the euro area is suffering from low economic growth. While monetary policy has delivered a lot of support for the euro-area economy, it cannot bring about long-lasting economic growth and is therefore not our focus in this article. Other economic policies are required here. To successfully enhance the prosperity and stability of the euro area, three economic pillars have to be built: resolute national structural reform programmes, an ambitious financing and investment union, and improved euro-area economic governance.

Resolute national structural reform programmes are the key to improving growth and employment. Let us begin with France: obviously, the functioning of the labour market has to be improved and the dualism between fixed-term and open-ended contracts has to be addressed; the cost of unskilled jobs has to be further reduced along with the CICE (tax credit); the education and training system has to be revamped in order to build employment pathways for young people – promoting apprenticeship could be the best way forward in this regard. On the goods and services markets, competition has to be strengthened by removing barriers to entry and exit, especially in the services sectors. As regards public debt, efforts should be pursued to reach more sustainable levels. To this end, fiscal discipline has to be enhanced through more rigorous management of expenditure.

Despite Germany's more favourable economic situation, further reforms are necessary here, too: due to demographic changes the workforce is expected to decline – and the current strong influx of refugees will not significantly change that picture. This will lead to sluggish longer-term growth. The demographic burden can be addressed by operating two main levers: raising the retirement age to keep up with rising life expectancy; increasing the participation rate, particularly by encouraging more women to enter the workforce. The childcare and education infrastructures need to be improved and expanded. Germany's tax and transfer system can be changed to strengthen incentives to seek gainful employment. Decisive policy action is required to equip the refugees that are staying with the language and job skills necessary to succeed in the labour market. And impediments to productivity growth could be removed by lowering barriers to market entry – for instance, by liberalising and deregulating the self-employed professions or eliminating hurdles to business start-ups.

In addition to structural reforms at the national level, growth-enhancing measures at the European level are necessary. Tearing down the existing barriers to a common services market and a common digital market in Europe holds out the promise that the gains achieved by integrating goods markets can be multiplied.

The second milestone on the road to strengthening the euro area is the implementation of an ambitious "**financing and investment union**". Indeed, one of the central challenges facing the euro area is the discrepancy between the abundance of savings and the lack of appropriate investment financing. Europe can do better at bringing the two together, and equity seems the most promising route to take. It is a well-known fact that the equity share of corporate financing in Europe is half as large – and the debt share of corporate financing that much greater – as in the United States. This is unfortunate because equity financing is the better way to share risks and opportunities, as well as to support innovation. The integrated US equity market for example cushions about 40% of a state-specific economic shock, as a company's profits and losses are distributed to owners all over the US. In the euro area, this form of risk-sharing is virtually non-existent. Moving towards US levels would make the euro area a far more resilient currency union. The European Commission's project for a Capital Markets Union (CMU) addresses some of these issues. Taken individually, initiatives such as the CMU, the Juncker investment plan, and the completion of the banking union – once the preconditions are in place – might not exactly stand out. However, in a more streamlined form and rebranded as a "financing and investment union" they will collectively be capable of better channelling savings into productive investment in Europe.

Finally, when it comes to fiscal and economic policy, the **governance of the euro area** has to be reinforced. The present asymmetry between national sovereignty and common solidarity is a threat to the stability of our monetary union. Regrettably, the coordination framework that was put in place as a safeguard was unable to prevent public finances from worsening and economic imbalances from building up, as was demonstrated not least by the Greek crisis. We are clearly at a crossroads, and the question that we must now answer is this: how do we extricate ourselves from this suboptimal situation?

More integration appears to be the most straightforward solution to restore confidence in the euro area, as it would foster common strategies for public finances and reforms, and thus growth. To that end, euro-area member states would clearly have to allow a comprehensive sharing of sovereignty and powers at the European level, which, in turn, would require greater democratic accountability. In this new framework, the euro area would rest on a stronger institutional foundation, which should be based on the central idea of European monetary integration: that EMU delivers stability and growth. It is up to politicians to design the new framework, but they could build on, for example, the following factors: an efficient and less fragmented European administration, to build a common Treasury for the euro area in conjunction with an independent fiscal council; and a stronger political body for policy decisions, under parliamentary control. These new institutions would restore the balance between liability and control.

However, if governments and parliaments in the euro area were to shy away from the political dimension of a fully-fledged union, this would leave just one viable option – a decentralised approach based on individual responsibility and even stronger rules. Under this scheme, the fiscal rules, which have already been reinforced through the fiscal compact and the European semester in particular, would have to be strengthened. In such a regime of increased individual responsibility, we would also have to make sure that risk, including that of sovereign exposures, is properly taken into account by all stakeholders – not least to reduce the vulnerability of banks should sovereigns run into financial troubles. Furthermore, it will be necessary to investigate how ESM rescue programmes could better involve private investors and how a sovereign debt restructuring process could be designed which does not put financial stability in the euro area as a whole at risk. Taking this direction would retain national sovereignty within the euro area – with a correspondingly lower level of solidarity. But this would represent the other avenue towards the realignment of liability and control.

Simultaneously published in "Le Monde" and "Süddeutsche Zeitung" 8 February 2016.