**Frankfurt School of Finance and Management – 12 December 2023**

# The reawakening of Europe and the Franco-German engine

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Dear Students, Professors, Ladies and Gentlemen,

I am delighted to be with you here today, and I extend my warmest thanks to former Bundesbank President Jens Weidmann, as well as to Professor Emanuel Mönch for their invitation. Lieber Jens, it is a great pleasure to meet with you tonight, admittedly in different circumstances to those we experienced during six years here in Frankfurt when the alphabetical seating chart at the ECB's Governing Council meant that we were seated almost side by side during meetings. We have shared a lot, while forging our mutual understanding and, even more importantly, our friendship. Tonight we are on the eve of a monetary Governing Council meeting and in a 'silent period'. In other words, I will not speak about monetary policy during this speech. Let me just recall that, after peaking at 10.6% in October 2022, inflation receded to 2.4% in the euro area last month [i].

Taking a step back, the euro has proved remarkably stable over time, with inflation averaging 2.1% since its introduction in 1999[ii], compared with 4.9% over the two previous decades. And the single currency has helped to protect the purchasing power of European citizens, which has grown by nearly 17% since 1999. The euro inspires trust, which is the core value of a currency, and has proved a popular success. The latest flash Eurobarometer poll, conducted in October, reported that 79% of euro area citizens (and 80% in Germany) are in favour of the euro: that's up from 63% a decade ago. The euro is "Europe in the citizen's pocket", and the most concrete and advanced form of European integration.

Tonight I would precisely like to focus on Europe, and on the Franco-German engine. Both are particularly dear to my heart as I am 100% French, but also 100% from Saarland, where my family has its roots… and therefore 100% European. Together with Joachim Nagel, who has succeeded Jens as Bundesbank President, we recently published a joint opinion piece [iii] calling for an engine reboot, 60 years after the Élysée Treaty.

Let's be honest: neither Europe nor the Franco-German “pair” are currently in the best of shape. Europe's weakness is the result of at least three crises: obviously, the geopolitical crisis, with the return of war both to our continent and to the Middle East. Next, a democratic crisis: in all of our Western countries, citizens are distrustful, political leadership appears diminished, and populism is on the rise election after election - including just recently in the Netherlands, despite having the most successful economy in Europe. And lastly, an economic and social crisis: although we avoided the worst-case scenario of a European recession, our fellow citizens – especially the poorest among them - are being squeezed hard by inflation, which has eroded their standard of living. And while the figures are improving significantly, the overall perception remains a negative one.

The upcoming European elections next June are likely to reveal this European crisis, and even ignite it, according to a more pessimistic view. In each country, the temptation for public opinion, and for embattled governments - beginning with the German and French ones - is to just focus only on *domestic* problems, and I am not underestimating these. But I firmly believe that this would be a mistake: the only way to successfully emerge from the European crisis is to adopt a bold European strategy and take a high view rather than low key solutions. This is what I would like to set out tonight from an economic perspective: (I) because we face more shared challenges than ever before and (II) because we have the solutions to these shared challenges if only we can all act together.

## I. Europe must successfully achieve its three economic transformations

As some of the crises of our recent past – including inflation – are gradually fading away, let us free ourselves from the tyranny of urgency, and grasp the three structural challenges that lie ahead of us. They are all of direct importance to you, the young generation: the transformation of work, and the digital and green transformations. And they all imply being less dependent on other continents and being more reliant on our own resources – call it having more “strategic autonomy” to deal with the geopolitical tensions of 2023.

*1. The transformation of work*

Germany is known for its outstanding track record on employment: for two decades up to 2019, the employment rate grew twice as fast as France's for example[iv], resulting in a considerable gap. In recent years, France has nevertheless started to bridge the gap, thanks to reforms in labour laws, unemployment insurance and the apprenticeship system. Despite these recent improvements, and the creation of more than one million jobs since the end of 2019, the unemployment rate is still at 7.4%, far from full employment, while recruitment difficulties still affect almost half (45%) of French companies. In order to close this gap up, the rapid development of skills – especially scientific skills – should be given a high priority. As you all know, there is a very strong correlation between economic growth and education. In Europe, we have some of the best education facilities. But, as the latest PISA scores released last week show[v], the Covid crisis has negatively impacted education and performance in many OECD countries: results in maths, reading and science have all plummeted in Germany and France when compared with 2018. But, if we take the long view, southern Europe – including my country – can take inspiration from northern Europe, which has generally been able to maintain higher standards of educational achievement. On-the job training is another factor in growth as tomorrow's jobs will involve even more change than today's. Take the example of digital experts: in 2022, there were 9.4 million experts, rising from 7.8 million in 2019, but still far below our target of 20 million by 2030[vi].

Furthermore, the transformation of work will increasingly involve common requirements for our two countries. The first shift is **psychological and managerial**. Beyond collective *enrichment through work*, we must find a way to *enrich work itself*. Despite what we often hear, I don't believe that young people - your generation - or Europeans in general, "no longer want to work" after Covid. But Covid has highlighted and amplified changes in motivation for work. The welcome adoption of teleworking, a strong demand for autonomy and professional mobility, as well as a real desire for a sense of purpose in work, are

all potential levers: none of these are easy for employers, but they too will have to change.

The second shift is now the **shortage of labour**, following a period of excess reflected in high unemployment. European countries will soon be directly confronted with ageing demographics: the tipping point, where the working-age population will start to decrease, is expected as early as 2024 in Germany, and 2028 in France.[vii] This quantitative issue also raises qualitative questions, in particular about how women (and men) can accommodate work and other imperatives more effectively, building on research conducted by Claudia Goldin, winner of the Nobel Prize in Economics this year. This transformation of work would be decisive because it would allow Europe to increase its potential growth rate. More generally, the question of productivity is returning centre-stage, which leads me on to our second – digital – transformation.

*2. The digital transformation*

We need to close the technology gap with the United States – and now with China as well. In terms of **innovation**, it is illustrated by the number of ICT (information and communication technologies)-related patents which has been almost twice as high in the United States as in Europe over the period 2014-2018. Obviously, all major Bigtechs are American or Chinese, not European. The same is true in terms of **adoption**: firms, in particular SMEs, tend to have lower levels of digitalisation in comparison to the United States, and hence lower aggregate total factor productivity growth.

Ongoing technological innovations, and especially current developments in artificial intelligence (AI), are opening up new horizons.[viii] Many people have concerns about how generative AI will impact certain professions and shake up labour markets. Indeed, for certain tasks, AI is likely to enable capital to replace labour in the short term. But AI will boost productivity, which will bring down prices of goods and increase demand. This is why I tend to be a cautious “techno-optimist”: the wisest approach, drawn from economic history, is to consider AI as a potential new technological revolution that traditionally leads to

"creative destruction" to quote Joseph Schumpeter, and therefore as an opportunity rather than a threat. It means at once regulating AI and developing it, rather than fearing it.

What is at stake therefore is how we can help European digital services to scale up and become global players. One prerequisite is the take-off of venture capital in the EU, which is still five times less developed than in North America[ix].

### *3. The green transformation*

We learned hard lessons from our past dependence on Russian oil and gas: the imperative of strategic autonomy adds to the obvious threat of global warming. Both mean that we must reduce our consumption of fossil and imported fuels. Europe has made strong commitments in this area, first with the ongoing EU electricity market reform, which encourages investments in renewable energy thanks to long-term contracts, and second, with the aim of achieving carbon neutrality by 2050. This path is defined in very concrete terms in the EU's "Fit for 55" package, which aims at reducing net greenhouse gas emissions by at least 55% by 2030. France and Germany obviously share the same goal of a decarbonised, independent and competitive energy mix. But they disagree on the means of achieving this: France will not give up on nuclear power and will use renewable energies alongside this, while Germany has definitely begun its exit from nuclear power. As we will not overcome these differences, we should accept them, instead of exporting them throughout the rest of Europe.

To succeed in achieving radical energy transformation requires tremendous adaptation from all economic agents. Providing appropriate market incentives is paramount. Here I need to reiterate what is economically obvious, even though politically unpopular: a higher carbon price is essential. The United States under Joe Biden has taken a different path: its efforts through regulation and public subsidies - the much heralded IRA (Inflation Reduction Act) - are going in the right direction, but will not be enough. Whatever form it takes – paying for emission allowances, taxation, etc. –, carbon pricing needs to be global – and not just national – and socially equitable. Europe must relentlessly press for this

"new frontier". Carbon pricing is needed to align firms' behaviour, but also develop private financing through attractive yields on green investments. This brings me on to our shared European solutions.

## **II. Europe has the solutions to succeed, if it acts as one**

Europeans are probably in agreement as regards the challenges. But when it comes to solutions, a feeling of powerlessness appears to loom, as Europe is trapped by an overly-domestic and short-term agenda. This European torpor is all the more irksome in the face of American speed[x] and Chinese assertiveness. But it is by no means a fatality: from the end of the 19th century, Europe built a unique political narrative, reconciling economic growth and social justice with a pioneering "European social model" – or call it "*soziale Marktwirtschaft*". The European narrative in the 21st century – for our fellow citizens as well as for the rest of the world – should be how to reconcile growth and sustainability, prosperity and ecology. And to achieve this promise, I firmly believe we have to harness the full potential of two strong economic levers: the single market and a financing union.

### *a) The single market*

The single market is often seen as something in the past, a grand economic legacy that has come down from Jacques Delors. On the contrary, the single market is clearly a topic for the future: it is one of the world's largest markets, but it has not yet been fully tapped. A deeper single market would help leverage the EU's unique blend of innovation and manufacturing strengths, thereby generating higher growth and building greater resilience in a fragmented world. In a recent study, the IMF [xi] estimates that lowering internal barriers and frictions, for instance by harmonising taxes and subsidies across countries, would generate large welfare effects on the order of 7% of GDP. This would benefit both EU manufacturing and innovating countries, and Northern and Southern countries alike.

On this basis, Gita Gopinath, first deputy managing director of the IMF, made sharp recommendations in her recent speech in Berlin [xii]. There is indeed ample

room for more intra-EU integration, and I quote her: “Better harmonizing taxes and subsidies across countries would increase investment in cross-border infrastructure and discourage “state aid” shopping. In contrast, the recent surge in national measures, including to address the energy price shock, risks damaging the single market by giving those countries that provide large fiscal support to their industries a competitive edge over their EU peers.” Let me echo this call: EU state-aid control is not a bureaucratic burden; it is a key requisite to achieve a fair and optimal allocation of resources within our single market. It should now be fully re-implemented.

“This is best illustrated in the area of decarbonization. Given the externalities from carbon emissions, decarbonization targets should be set at the EU level, rather than at the level of individual members, to make sure efforts are concentrated where marginal abatement costs are lowest across the EU. This will ensure the largest possible emissions reductions are achieved for a given amount of green investment. There is arguably a role for government intervention to de-risk energy supply and slow climate change, including through providing support for renewable energy production and establishing the critical network infrastructure of smart grids and electric vehicle charging stations. To finance these interventions, an EU-wide central fiscal capacity of a meaningful size can help ensure resources flow to where they have the highest benefits, and not where governments are more able and willing to provide state aid.”

National governments must avoid creating competitive advantages over other EU countries. We should rather channel our forces towards a truly European industrial policy, supported among others by public-private partnerships, and increase investments in cross-border infrastructure. To achieve this, European competition policy needs to be more strategically oriented. We should in particular aim for a **digital single market** combining regulation, financing and talent development.

*b) A financing union*

Conventional wisdom states that the three transformations mentioned previously are desirable but impossible to finance. I would like to refute this idea.

The climate transition will be by far the most capital intensive. The amounts involved may look daunting, especially when presented in absolute terms: possibly around 620 billion euros per year of additional investments in the EU through 2030, according to the European Commission's latest estimates.[xiii] This represents up to 3.9% of EU GDP, which the public sector can only partially finance due to the high level of public debt. In this regard Europe needs a common stability framework to recover some leeway, with new fiscal rules hoped for in the very next days: let me stress that we need rules, remaining at once pragmatic and not too complex.

The climate transition can be financed, subject to a key prerequisite: that the private sector shoulders the bulk of the financial effort, and that we unlock cross-border capital flows for the transition. This is the strongest argument in favour of a Green Capital Markets Union (CMU), which I also advocated as early as 2019 with Jens Weidmann[xiv], and more recently with Joachim Nagel [xv]. But why don't we make more progress? I fully concur with ECB President Christine Lagarde that Europe should make a "Kantian shift" in our approach to CMU [xvi]. As she strongly stressed, Immanuel Kant boldly stated that, instead of the world creating our perception, it is our perception – and our will – that defines how we experience the world. Translated to CMU: let us go beyond the rather technical and bottom-up details of the current action plan, and dare a great political ambition "from the top". A higher purpose – financing the green and digital transitions – would facilitate much greater ownership and favour faster implementation.

The digital transformation will, for its part, require another 125 billion euros every year. Blended finance is needed for both transformations: the right mix of public and private financing could require more specifically a type of investment contract that tempts in private investment in the wake of public funding.

Furthermore, the Banking Union, which has been so far only half implemented, is a natural complement to the CMU. I hereby call – loudly and clearly – for a "green and digital Financing Union". Together, Pan-European capital markets and banks will be a powerful vector, enabling funds to flow freely across the euro area, especially for the use of the euro area's excess of savings over investment, which should amount to around 370 billion euros or 2.6% of GDP in 2023 [xvii].

As part of a CMU, it is necessary to increase the supply of safe euro-denominated assets. Following the welcome launch in 2021 of the Next Generation EU (NGEU) programme, a first step in forging a unified approach to financing EU borrowing was taken by the Commission in 2023. Under this approach, bonds[xviii] can be issued under the single name of "EU bonds", which has the advantage of avoiding fragmentation and boosting the liquidity of issues. But we need to go much further, by aiming to combine the bond issues of the Commission, the European Stability Mechanism (ESM) and possibly the European Investment Bank: the pool would amount to 1,100 billion euros, and we would then create a genuine European resource and benchmark.

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I would like to conclude by quoting a great American, born in Germany, who has just passed away. Henry Kissinger is reputed to have asked "Who do I call if I want to speak to Europe?" The exact quote would appear to be apocryphal, but the question remains a valid one – leadership *in* Europe, and especially, leadership *of* Europe. The dangerous world of 2023 requires the reawakening of Europe, a force for peace and cooperation. And the anxious Europeans of 2023 need the reawakening of Europe, if we are to fulfil our promise of a sustainable prosperity. I have set out tonight a number of shared economic solutions. I would wish them to be part of the debate in the European elections, and I would still more wish them to support a shared Franco-German ambition. To divide France and Germany would be to condemn our two countries – and Europe – to insignificance. But we can and must come together again, as we did in 1950 when facing the challenge of reconstruction, and in 1990 when

facing the challenge of reunification. If we can deal with the present challenge of strategic autonomy, we will have begun to answer Kissinger's question. Thank you for your attention.

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[i] Eurostat, flash estimate of headline inflation in November 2023
[ii] Average of year-on-year inflation rates between January 1999 and October 2023
[iii] Nagel, J., and Villeroy de Galhau, F., *Gedanken für französisch-deutschen Freundschaft*, *Le couple franco-allemand est nécessaire*, joint opinion piece, 13 November 2023
[iv] around 1 % per year between 1998 and 2019, against 0.5 % for France
[v] OECD, *PISA (Programme For International Student Assessment) 2022 results*, 5 December 2023
[vi] European Commission, *Europe's digital decade: digital targets for 2030*
[vii] OECD, Population projections
[viii] For example, for summarising, extracting and classifying data, or for generating computer code or text.
[ix] Bruegel, *Venture capital: a new breath of life for European entrepreneurs?*, 10 February 2022
[x] Villeroy de Galhau, F., *Europe's growth gap: reconciling Keynes and Schumpeter*, high-level lecture at College of Europe in Bruges, 31 March 2021
[xi] IMF, *Geoeconomic fragmentation: what's at stake for the EU*, 30 November 2023
[xii] Gopinath, G., *Europe in a fragmented world*, speech, 30 November 2023
[xiii] European Commission, *2023 Strategic foresight report*, July 2023
[xiv] Villeroy de Galhau, F., and Weidmann, J., *Towards a genuine capital markets union*, 4 April 2019
[xv] Nagel, J., and Villeroy de Galhau, F., *Fostering European unity: time for a genuine Capital Markets Union*, published in French in Les Echos and in German in Handelsblatt on 14 November 2022
[xvi] Lagarde, C., *A Kantian shift for the capital markets union*, speech, 17 November 2023
[xvii] European Commission, *European Economic Forecast, Autumn 2023 – Statistical Annex*, November 2023
xviii For example, to finance the NGEU recovery programme and macro-financial assistance for Ukraine.