Speech at Resilient Europe Conference, Brussels

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30/09/2015
Speeches
ESM
Brussels, Belgium

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"Risk sharing and resilience in the euro area"
Speech at conference on Building a Resilient Europe
Brussels, 30 September 2015

I am delighted to be here with you to speak on the topic of resilience. As you can see from the line-up of this panel, resilience is a concept that can apply to many fields. Today's agenda covers energy, food production and migration. Resilience in my own field –that of the prevention of financial crises, or responding to them –is perhaps less tangible.

In this area, we have learned a lot from the crisis. We've done many things to strengthen Europe's economic policies, financial systems and crisis institutions. That has improved Europe's financial resilience and that's what I'd like to talk about during the next 15 minutes.

In 2008, the world was hit by the worst financial crisis since 1929. Much has been written about this, and I don't need to go into detail. It was initially a global crisis, triggered in the U.S. It was not a crisis that Europe could have prevented on its own. But the sovereign debt crisis that followed it and came on top of the global financial crisis, had its origin in the euro area, and has been keeping us busy ever since.

Some countries had allowed excessively high fiscal deficits for too long, and consequently had too much public debt. Others had lost competitiveness, and needed structural reforms. And yet others were coping with real estate and credit bubbles, which, when they burst, became a particular burden for banks, and in some cases governments. Finally, the European surveillance framework was far too late in spotting some of these risks, in particular the macro-economic imbalances.

Since then, we have made some truly great strides in addressing these issues and sharing more risks between countries. The euro area has erected a common crisis firewall, with pooled resources, in the form of the ESM, and its precursor the EFSF. As the head of these two new institutions, I will first elaborate in greater detail on what we have done over the past five years. I will then turn to what lies ahead. What further steps are needed, and are doable?

The ESM is a permanent euro area institution that functions as a firewall against financial crises. Together with the EFSF, it can provide loans to countries in financial trouble up to a maximum of €700 billion. Five countries have received such loans: Ireland, Portugal, Spain, Cyprus and Greece. In total we have disbursed some €250 billion in loans.

Our programmes have enabled countries to get their houses in order at a time that they were unable to borrow money on markets. But before they get the cash, they must commit to tough reforms that address weaknesses in their domestic economic and financial policies. This is painful in the short-run, but indispensable to repair public finances, regain competitiveness and strengthen growth.

Four out of our five programme countries are success stories now. Spain, Portugal and Ireland have exited our programmes, and Cyprus is clearly on the right track. Spain and Ireland have the highest growth rates in Europe, while Greece is a special case. It has now entered a third programme, and is implementing a very comprehensive reform package.

Our programmes bring a lot of solidarity to the borrowing countries. The budget savings are huge. This is because we can raise money at low cost, thanks to our strong credit rating, underpinned by the support of our Member States. We then pass on these favourable financing costs to the programme countries. The financing burden for these countries drops further because of the long maturities of our loans, and possible interest rate deferrals. For Greece, for instance, payment obligations to euro area creditors over the years to 2023 have become minimal. We estimate that our lending produces annual savings of €8 billion for the Greek budget, which is more than 4% of Greek GDP. These are big numbers.

And yet, this comes at no cost to European taxpayers. We finance our loans in financial markets, and we do not lend out taxpayer money. As I already indicated, this is due to government guarantees, in the case of the EFSF and because of our shareholder capital in the case of the ESM. And this capital could, in extreme circumstances, be at risk. But this shows my point exactly. By sharing risk, euro area countries have increased the resilience of the region's economy. If our institutions had been around in 2010, the crisis in Europe would have been less severe and a response could have been provided faster.

Many other measures have been taken over the last five years. Eurostat, for instance, now has greater powers to examine the accounts of Member States. Had this been the case earlier, we would have known earlier that Greece's public deficit was spiralling out of control. The European systemic Risk Board, set up in 2011, now monitors asset bubbles, while the European Semester forces more transparency and consistency in budgetary policies.

And last but not least, the Excessive Imbalances Procedure is a new mechanism to detect macroeconomic imbalances such as a high level of private and government debt, credit or housing bubbles, weak productivity, or large current account imbalances. I cannot emphasise enough how important competitiveness is in enhancing economic resilience, especially in small open economies. And the new procedure is a useful tool for monitoring that.

Let's also not forget that the European Union has long put a strong emphasis on economic convergence and mutual assistance. People often don't realize that while the EU budget is small – a little over 1% of GDP – Member States can receive substantial transfers of up to 3% of their economies. These are permanent transfers, not related to monetary union. Still, if used wisely, they can help the catching-up process enormously.

But there is no room for complacency. Risk-sharing facilitates income and consumption smoothing, and reduces vulnerability to external shocks. The global financial crisis struck each country differently, depending on the structure of its economy and banking system, at a time when divergences of our economies increased.

So what further steps are needed? A key aspect is to push through the European Commission’s Capital Market Union, and to conclude Banking Union. Let me briefly explain what these two initiatives are about.

The Capital Market Union aims to diversify financing sources to an economy. This would allow risks to be shared via markets across countries. It is well known that companies in Europe rely far more on bank lending, and less on capital markets, than for instance companies in the United States. This concentrates risk in banks and typically the banks are located in the same country as the borrower. Opening up capital markets for companies broadens their investor base. Not only geographically, but it will also bring in investors with differing risk appetites and time horizons.

This will improve resilience. It is not an easy task, and entails such projects as harmonising rules for private placements, accounting practices and bankruptcy law across the European Union. But it is an important one. Other complex topics that need scrutiny are securitisation, which can help banks fund their businesses, prospectus requirements and the risk-weighting of assets for capital purposes.

We also need to do more to strengthen our banking system. As part of the Banking Union, there is now a common banking supervisor, the Single Supervisory Mechanism. It comprises the ECB and the national supervisory authorities of the participating countries.

Secondly, a new body that can step in to restructure or resolve faltering banks, the Single Resolution Board, will start its work in 2016. On the other hand, deposit insurance schemes are still organised at a national level. A common system and a financial backstop for the SRB are the two key measures that would complete banking union.

Looking further ahead, many policymakers and institutions are saying that still more integration is warranted to increase risk-sharing and make the economic and monetary union more resilient. The Five Presidents’ report, for instance, suggests a fiscal capacity for the euro area. This would of course add to risk sharing in the euro area. But there are currently very divergent views in our Member States on this proposal.

In my view, a limited fiscal capacity that does not lead to permanent transfer and debt mutualisation would help to provide risk sharing and could be politically less controversial. It could also be implemented without changing the EU Treaty.

To summarise, financial resilience is important for Europe and, in particular, the euro area. A lot has happened in this respect during the last 5 years – more than anybody expected at the beginning of the crisis.

With all that, monetary union will work better after the crisis than before the crisis because of significantly strengthened risk sharing via EFSF/ESM lending and the banking union. Consequently, the resilience of the euro area is stronger today than before the crisis. Recent proposals from the Commission would strengthen resilience further.

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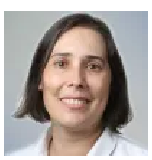

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