The monetary union: stable despite crises - speech by Klaus Regling

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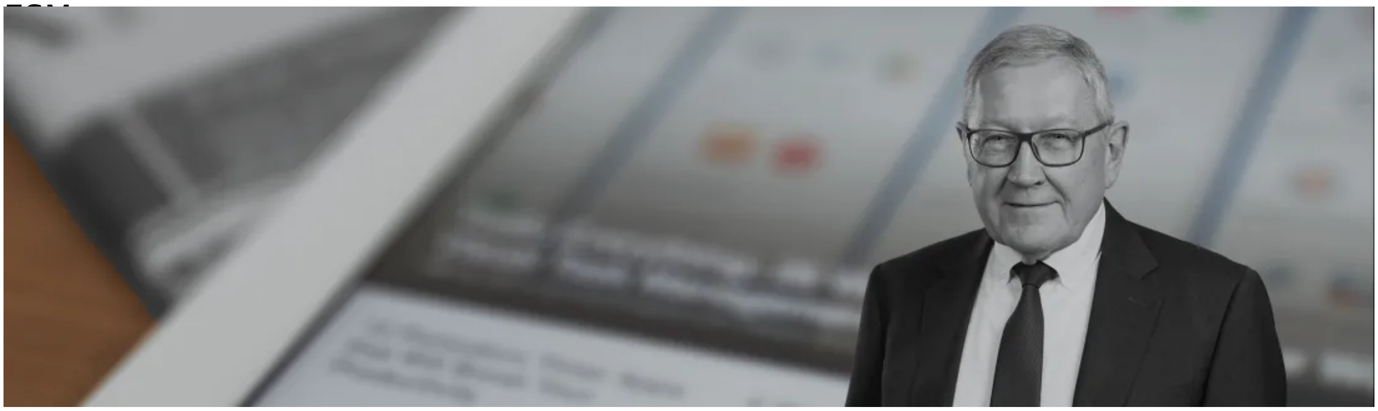
Speeches



Klaus Regling, ESM Managing Director
“The monetary union - stable despite crises”
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"The future of the euro" - this was the title of the speech I gave at the University of Regensburg in 2011, when the Faculty of Economics awarded me an honorary doctorate. “The euro will not fail - on the contrary, it will emerge stronger from its current crisis.” That was my message at the time, at the height of the euro crisis. And it led to skeptical amazement among many in the hall.

Today, ten years later, I am still talking about the euro. Not only because I am a convinced European - but also because I believe that the euro is an important and necessary component of European integration and indispensable for strengthening

European sovereignty.

First, a brief look back.

A lot has happened in the years following the euro crisis. We had recognised the weaknesses of the monetary union and gradually compensated for them. Thus, several new institutions were created to improve the prevention and management of crises.

The temporary euro recue fund EFSF was established in June 2010.

The same year saw the establishment of the European Banking Authority (EBA), a regulatory body that develops standards and rules for the banking sector, and the European Systemic Risk Board (ESRB), which monitors the European Union's financial system, mainly to prevent or limit macroprudential risks.

The next year, the European Securities and Markets Authority (ESMA) was added, which improves investor protection and promotes stable, regulated financial markets.

Then the temporary rescue fund was followed by the permanent crisis fund for the euro area, the ESM, the institution I manage.

With the start of the banking union, the Single Supervisory Mechanism (SSM) was created in 2014. It directly supervises the 130 systemically important banks in the euro area. Banks whose failure could significantly shake a country's economy and financial system.

Since 2015, the Single Resolution Mechanism has ensured that financial institutions threatened with insolvency can be resolved with the least possible impact on the economy and on public finances, if necessary.
The creation of these new institutions was a leap forward and has strengthened the institutional foundation of the monetary union. Our work in recent years - aimed at making the monetary union more crisis-proof - has helped us in the current pandemic.

In the last 1 ½ years, we have undoubtedly experienced the worst crisis in the history of the EU. The pandemic has changed Europe - economically, politically, and socially.

But Europe has responded convincingly to this profound crisis: As an immediate response to the pandemic, three EU safety nets were put in place – already in April last year - with a combined size of €540 billion.

- A pandemic credit line by the ESM to finance healthcare costs;
- A European Commission safety net for workers; and
- Additional loans from the European Investment Bank for business investment.

In addition, the €750 billion Recovery Plan, also known as the "NextGenerationEU", was adopted last July. It supports economic reforms and the green and digital transformation to enable sustainable growth in EU countries in the long term.

To achieve balanced growth across the EU, countries particularly affected by the pandemic receive more support. Solidarity in the EU has thus reached a new dimension. This solidarity is important. Without it, economic disparities within the EU would increase sharply, which would be detrimental to both the functioning of the internal market and the monetary union.

Moreover, "NextGenerationEU" can accelerate economic structural change and the transformation to "green" and "digital", and advance European integration. We should use this potential.

European integration also includes the further deepening of our monetary union. It is right that the EU is now focusing on fighting the pandemic. However, we should not lose sight of the deepening of the Economic and Monetary Union: it is important in order to be even better prepared for future crises and to strengthen European sovereignty.

I wrote my diploma thesis at the University of Regensburg in 1973 on the "Theory of Optimal Currency Areas": a theory that had been developed by Robert Mundell at the time and that is still relevant today and, what is more, one of my favourite topics.

Having been involved in monetary union for almost 50 years now, I know that there is still work to be done to make the euro area even more resilient. Having focused on the creation of new institutions over the last decade, I now see a need for action in the following areas:

A banking union and a single market for financial services - a capital markets union - would have many benefits: they would contribute to stronger growth in Europe by allocating capital more efficiently between EU countries. The more efficient use of capital would facilitate cross-border investments, strengthen the competitiveness of the euro area and open up new ways of financing companies. This is particularly important now to help the euro area economy grow again in the recovery phase after the pandemic.

Some difficult decisions still need to be taken to complete the banking union, including a common deposit insurance scheme, but also improved cross-border integration of the banking sector and diversification of sovereign bonds on bank balance sheets. This is a particularly sensitive issue in Germany.

The next important step towards the completion of the Banking Union is the ESM backstop to the Single Resolution Fund. This backstop is an important element of the ESM reform, which will come into force at the beginning of 2022 and help to further improve financial stability in the euro area.

Besides the banking union, the capital markets union is the other major project to strengthen risk-sharing in the currency area. A fully integrated financial market would dampen cyclical divergences between member states through the markets. At present, however, the euro area consists of 19 national capital markets with their own rules and barriers to cross-border investment. A prerequisite for a capital markets union is likewise the harmonisation of insolvency law, the alignment of the tax base for companies, a legal framework for crypto-assets and the simplification of rules for stock exchange listings.[1]

Our monetary union would already become much more robust with a full banking and capital markets union. Not only because it would strengthen growth, but also thanks to risk-sharing.

But risk-sharing can also be done through public channels. This is already happening today through the EU budget, through loans from the European Investment Bank, through the financial assistance of the ESM and through "NextGenerationEU" in the coming years. However, "NextGenerationEU" is limited in time and tailored to the needs of all EU countries, but not the euro area.

For the euro area, there are other possible options on how to share risks: It would make sense to supplement the toolbox of monetary union with an additional instrument for macroeconomic stabilisation.

As I also described in my thesis at the time, countries in a monetary union need more fiscal emergency buffers than countries with their own currency. This is because the countries of a common currency have given up two important economic instruments: namely, their own monetary policy and the exchange rate of their own currency. Thus, fiscal measures are the only macroeconomic tool for these countries to counteract an external shock - such as a pandemic.

A central fiscal capacity would supplement the national budget buffers of member states in a crisis with a European budget buffer to cushion economic downturns. The ESM could take on this additional task.
As a further step, I see the need to reform the Stability and Growth Pact. This pact coordinates budgetary policy and ensures the debt sustainability of the euro countries.

Because of Covid-19, the rules for controlling national deficit and debt levels are still suspended until the end of next year. This gives us a window of opportunity to revise the rules, make them simpler and adapt them to the new economic environment.

The European Stability and Growth Pact was in need of reform even before the pandemic. Its main elements date back to its introduction in the 1990s and do not reflect the changed macroeconomic environment.

At present, debt is indeed sustainable in all member states of the monetary union. This is - to some extent - the result of low interest rates and the monetary policy measures of the European Central Bank. But interest rates will not stay this low forever. And at the same time, new costs - such as the costs of an ageing society - will put an additional burden on countries' budgets.

As you see, there is a lot to be done in the future to make the monetary union even more crisis-proof. This also makes sense because all the additional steps to complete the monetary union that I have mentioned would also strengthen the international role of the euro.

Despite serious crises, Europeans support the euro. This is reflected in surveys: across the euro area, the single currency has reached its highest level of popularity since its introduction, at almost 80%.

The completion of the banking union and progress towards a capital markets union would - together with a fiscal stabilisation instrument - also make the euro more attractive for global investors and thus strengthen its international role.

We should therefore use the current crisis as an opportunity to address economic weaknesses, to accelerate the digital and green transformation, and to deepen the monetary union.

So I conclude today - as I did ten years ago - with a confident message: not only the euro, but also Europe, will emerge stronger from the current crisis.

Thank you very much.

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[1] Momentum builds for Europe’s capital markets union | European Stability Mechanism (europa.eu)

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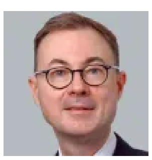

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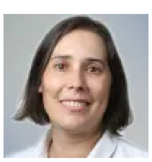

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