Klaus Regling's speech at the Atlantic Council

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The European Stability Mechanism - A firewall for the eurozone and first line of defense for global financial stability
Speech by Klaus Regling at the Atlantic Council EuroGrowth Initiative event
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(Please check against delivery)

Ladies and gentlemen,

The financial crisis began almost 10 years ago, so it seems an appropriate time to take stock of Europe's policy response, and to assess some of the results. The European Stability Mechanism, which I manage, originated in the crisis. So I will first briefly summarise what the ESM has been doing over the last few years.

I will then talk about the European economy, which is doing much better than is often recognized. It has some underlying strengths that help us contain rising scepticism towards globalisation and international trade on our continent.

Finally, I will put the ESM's role in a global context. We are the crisis resolution mechanism of the euro area, but we work with other regional firewalls and, of course, with the IMF. These institutions are crucial layers of the Global Financial Safety Net, or GFSN.

Let me start with the ESM. It is a lender of last resort for sovereigns, a function that did not exist in Europe before the crisis. A predecessor, the EFSF, was set up in 2010 as a temporary institution, and the ESM as a permanent solution in 2012. These two bodies share the same staff and building in Luxembourg.

The total lending capacity of these two institutions is €700 billion. We have disbursed €265 billion in loans so far, and committed €320 billion. Unlike the IMF, which refinances itself through central banks, we fund ourselves in the market by issuing bonds and bills. The ESM can do this at a very attractive rate of around one percent, because of its capital of €700 billion. Of this, our shareholders - the 19 euro area countries - have paid in €80 billion in cash. Our strong credit rating is due to these large amounts of overall and paid-in capital, which are higher than at any other international organisation.

The borrowing cost that we charge programme countries equals our funding cost plus a very small fee. This means huge budget savings for the programme countries. We have estimated that Greece saves €10 billion each year because of this – or 6 percent of GDP. This is crucial to make Greece's debt burden sustainable again.

ESM loans are granted only against the promise of strict economic reform packages. This approach of conditionality has been tried and tested by the IMF. In short, the ESM is a firewall that allows a country to get its house back in order during a programme, usually three years. And the approach works. Four of our five programme countries have successfully completed their programmes: Ireland, Spain, Portugal and Cyprus. And they are doing well: they are reform champions, according to the OECD and World Bank. Spain and Ireland have the highest growth rates of Europe and unemployment is falling rapidly. Greece remains a special case, and I will say a few words about that in a minute.

It is true that Europe's policy response to the crisis could have been swifter. But this is understandable, because the euro area consists of 19 independent countries that have pooled together only a small part of their sovereignty. Our crisis response has been quite comprehensive, and successful. The ESM isn't the only new institution. Europe also set up a series of new bodies in what is known as banking union: the Single Supervisory Mechanism, the Single Resolution Mechanism and the Single Resolution Fund. Many of these steps would have been unthinkable only a few years ago.

The European economy is doing well overall, another fact that is not sufficiently recognized. Growth in Europe is above potential, so the output gap is closing, and unemployment is coming down. It is true that potential output growth seems low. But in per-capita terms, economic growth in Europe is similar again to that in the US, just like it was for decades until the crisis hit. And per capita growth is an important indicator for policy making, because it measures the average rise in standards of living, taking out differences in population growth and therefore Europe's poor demographics.
What's more: participation and employment rates in Europe are higher today than in the year 2000. That means that a higher percentage of the population actually has a job today compared to 15 years ago, despite our high unemployment rate. In the US, the participation rate has decreased during the same period.

Last but not least, benefits from growth are spread more equally in Europe than in America. In Europe, 80 percent of the population has seen real income growth in the last 15 to 20 years. In the US, that was the case for only 10 to 20 percent. The GINI coefficient shows income inequality has always been worse in the US than in Europe – like in China – and has declined further the last 10 years. Income distribution in Europe is actually better than anywhere else in the world. Needless to say, income inequality is one driving force behind the growing scepticism towards globalisation, calls for protectionism and the success of populist parties across the Western world.

Let me now say a few words about the Global Financial Safety Net. The IMF and the so-called Regional Financing Arrangements such as the ESM are important layers of the GFSN. Foreign exchange reserves and central bank swaps are the other layers.

Last month, the G20 Finance Ministers and Central Bank Governors reiterated their commitment to strengthen the GFSN, and to improve cooperation between the IMF and the RFAs. The ESM is the biggest among the RFAs, which exist in Latin America, the Middle East, East Asia and Central Asia. They can usefully complement the IMF, and there are particular advantages of having an RFA in a currency union.

Firstly, RFAs have in-depth knowledge of regional economies. Secondly, the ESM can mobilise far more resources than the IMF, which is typically needed when a country in a currency union loses market access. Members of a currency union are much more connected with partner countries than others. Consequently, the IMF alone could simply not have met Greece’s financing needs.

Thirdly, RFAs can provide specific tools to address regional problems. The IMF could for instance not take part in Europe’s loan for Spain, because it was designed only to recapitalise the country’s banks. The IMF cannot do such sectoral lending.

Fourthly, RFAs can be more flexible with their lending terms. The lending rates of the ESM are only about a third of those of the IMF, and our loans for Greece have very long maturities – 32.5 years on average. Moreover, there are long grace periods in which Greece will not service any debt to the ESM at all. Thus, ESM lending greatly contributes to Greece regaining debt sustainability.

This makes the ESM better equipped to deal with the crisis in Europe than the IMF, particularly on the debt side, and this is what we have been debating in the past few months. The IMF has a different perspective on its assistance programmes: it can only stay in a country for a maximum of 10 years and needs third-party assurances that it will get its money back by that date at the latest. But the ESM is a long-term partner for countries such as Greece. Euro area finance ministers have already promised that they will give further debt relief at the end of the programme and beyond, should Athens need it. But this is hard to incorporate for the IMF, at least with their current toolkit.

In short, the relationship between the IMF and RFAs such as the ESM is evolving. I believe the IMF should clearly remain at the centre of the International Monetary System. We also hope very much that it will take part in the current third programme for Greece in the coming months. And finally on Greece, I am confident the country can return to the market and stand on its own feet again before the programme ends next year. As long as it implements the reforms that it has promised, it can be Europe’s next success story.

I now look forward to your questions, and those of the audience.

Author

Klaus Regling
Managing Director

Contacts

Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu