The Economic and Monetary Union: past, present and future - speech by Klaus Regling

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(Please check against delivery)

Your Royal Highness,
Excellencies,
Distinguished guests,

Good afternoon.
I vividly remember that phone call I received on a Monday evening in June 2010. I was in Brussels, where I had just set up my consultancy firm after spending a year at a university in Singapore. Carsten Pillath told me that the Eurogroup was looking for a CEO for the newly created European Financial Stability Facility (EFSF). Jean-Claude Juncker thought I was a good candidate to set up such a fund. In case of interest, I would be interviewed the next day.

The next morning, I drove to Luxembourg where an ECOFIN Council meeting was taking place. I was interviewed by three euro area finance ministers and Thomas Wieser, who reported back to the full Eurogroup. It went well – I had never gotten a job so quickly. [And I hope I did not disappoint you, Jean-Claude].

Many thought that the mere creation of such a fund would reassure markets, that it might never be used, and be temporary. In fact, I was afraid I would not have much to do after setting up the new institution. Well, we know it went quite differently than expected. Twelve years later, I am speaking to you days before the end of my mandate.

The first weeks and months at the EFSF were very hectic. My first important task was to convince investors that our bonds were worth buying, and that the euro was here to stay. Without investors, the whole scheme could not work. The pressure was on. It was a crucial moment, as investors in some parts of the globe, especially the Anglo-Saxon world, were convinced the euro was doomed to fail. Fortunately, I could convince other investors, most importantly in Asia, of the perennity of the euro. Hence, we were able to secure our funding. Seven months after its creation, the EFSF – staffed by only eight people – had to issue its first bonds, €5 billion, to finance the Irish programme.

After the EFSF had helped three euro area countries, it became clear that a permanent firewall was needed. There was a loophole in the Economic and Monetary Union (EMU) architecture, as no lender of last resort for sovereigns had been foreseen for the euro area. The European Stability Mechanism (ESM) was created in October 2012.

In total, the EFSF and the ESM lent close to €300 billion to five programme countries. Our adjustment programmes were successful. All countries significantly reduced their macroeconomic imbalances, regained market access and, after the end of their programmes, had a better economic performance than the euro area average.

Jean Monnet was right when he said that Europe would be forged in crises. With every crisis, EMU has become stronger. The euro crisis triggered the creation of significant institutional innovations. Next to the EFSF and the ESM, regulatory agencies for banks, markets and insurance companies, the single supervisory mechanism, the single resolution mechanism, and a macroprudential authority were created.

We are now facing the fourth crisis in 15 years. After the Global Financial Crisis, the euro crisis, and the pandemic, we have rediscovered the horrors of war at our doorstep. This conflict risks pushing the euro area into recession while also adding to inflationary pressures. This stagflationary environment makes policy-making and economic policy coordination more difficult. Rising interest rates have also triggered fears that another euro crisis is imminent. There are three reasons why I believe such fears are greatly exaggerated.

First, no country in the euro area shows macroeconomic imbalances comparable to what we saw during the euro crisis. During the first decade of monetary union, several countries experienced a substantive loss in competitiveness, which led to gaping trade deficits that required constant and unsustainably high capital imports and large fiscal deficits.

Second, interest rates are rising now. But the interest burden of budgets of euro area member states is at the lowest level in half a century in all euro area countries, despite much higher debt levels. It is still much cheaper for a euro area country to refinance its debt today than 10 or 20 years ago.

Third, the institutional innovations I mentioned earlier help safeguard financial stability within the euro area.

Thanks to these three factors, the euro area today is less vulnerable.
When looking back to the euro crisis, it is also important to remember that the solution to the euro crisis was three-pronged.

First and foremost, the programme countries themselves implemented ambitious adjustment policies. While this created hardship, these adjustment and reform programmes were key in tackling the economic problems that had accumulated over time.

Second, the European Central Bank introduced non-conventional monetary policy measures, which helped restore the monetary policy transmission mechanism. The announcement of the Outright Monetary Transactions in September 2012, which combines an ESM adjustment programme with potentially unlimited market intervention, had an important impact in this respect.

Third, conditional lending by the EFSF and the ESM at a time when no other financing was available for the countries in financial distress.

The euro crisis was overcome because these three actions unfolded simultaneously.
Although EMU has become more resilient, additional reforms are needed to fill remaining gaps.

Finalising banking union and completing the capital markets union would complement our single market with a single market for financial services.

This would lead to a better allocation of capital across the EU, strengthen potential growth, and increase risk-sharing via markets. This would reduce fragmentation and promote convergence within the euro area. Currently, we have 19 different capital markets, which is unattractive for international investors and a barrier to a stronger international role of the euro.

In addition, to complete the EMU architecture, we need a central fiscal capacity for the euro area. In a monetary union, countries have given up two major policy levers: the exchange rate and monetary policy. When faced with an asymmetric shock, the only macroeconomic lever that is left is fiscal policy. Fiscal policy will be used more often by countries that are members of a monetary union.

Hence, there is a strong case for introducing a central fiscal capacity to make the euro area more resilient by providing macroeconomic stabilisation and increasing public risk-sharing. It could be designed as a revolving fund, without additional transfers from member states. The ESM could add such an instrument to its toolbox, drawing on its existing infrastructure and financial resources.

Your Royal Highness,
Excellencies,
Distinguished guests,

Based on the many years I have been involved in European policy making, I draw two main conclusions. First, and this is the bad news, crises always occur. You don’t know where and when, but they do occur. The euro area has not escaped that fate. It has experienced different crises of different nature requiring different responses. Second, and this is the good news, we have always found a way to get out of these crises, becoming stronger in the process. What we should bear in mind for future crises though is that finding the right medicine for each case is key, especially when the symptoms are similar, but the root causes are different.

I am looking forward to the views and insights of our panellists.

Thank you for your attention.

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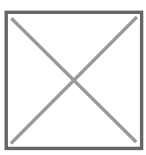

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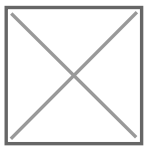

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