Conference “New challenges for the Economic and Monetary Union in the post-crisis environment” - speech by Pierre Gramegna

View PDF
18/06/2023

Pierre Gramegna, ESM Managing Director
Conference of the Euro 50 Group
“New challenges for the Economic and Monetary Union in the post-crisis environment”
Dinner speech
Luxembourg, 18 June 2023

(Please check against delivery)

Dear Edmond,

Dear friends,

It is a pleasure for me to kickstart this conference. The Euro 50 Group provides a valued platform where policymakers, academics, and representatives from the private sector can candidly exchange views on important European economic and financial policy matters. Thank you, Edmond, for having created this group back in 1999 with the help of Baron Alexandre Lamfalussy, a great European, who sadly passed away a bit more than eight years ago.

I will first touch upon the different pivotal steps taken to strengthen the euro area over the years. Then, I will delve into what, I think, yet remains to be tackled.

What has been achieved so far?

It is remarkable to look back at how the euro area evolved over the last 15 years. Since 2007, it has faced four crises: the global financial crisis, the sovereign debt crisis, the pandemic, and the horrific war that is taking place at our doorstep. These subsequent crises have engendered major havoc but have also taught us lessons that helped deepen integration.

The first major innovation was the creation of the European Financial Stability Facility (EFSF) in 2010. Created in a state of emergency under corporate law in Luxembourg, it managed to issue its first bond in record time, only seven months after its inception. And this only with a handful of people under the leadership of Klaus Regling. It filled a major gap in the euro area architecture. When the euro was introduced, nobody thought possible that a country could lose market access. There was no lender of last resort for sovereigns. This function became permanent with the inception of the European Stability Mechanism (ESM) two years later. In total, both the EFSF and the ESM lent close to €300 billion to five beneficiary countries who implemented difficult reforms that allowed them to regain competitiveness and improve their public finances. Over the past years, their growth rates have compared well against the euro area’s average growth rate. These adjustment programmes can be seen as success stories, as they helped the beneficiary countries overcome the euro area debt crisis.

The European Central Bank (ECB) also played a key role. By restoring the transmission mechanism of the single monetary policy, it helped alleviate the pressure several member countries were facing to refinance themselves and helped instil market confidence.

Another fundamental step was the creation of the European System of Financial Supervision, which became effective in 2011. Composed of three regulatory agencies and the European Systemic Risk Board, its primary task is to provide consistent and effective financial supervision across the European Union (EU).

Starting in 2014, the creation of banking union was the next key building block in strengthening the euro area. The Single Supervisory Mechanism brought about a major improvement in banking supervision, bringing supervision of the most significant banks to the European level, within the ECB.

Both the enhancement of banking regulation and supervision led to an increase in bank capital and liquidity. During the global financial crisis and the sovereign debt crisis, banks were part of the problem. During the pandemic, they became part of the solution as they were strong enough to keep credit flowing into the real economy.

Then, the Single Resolution Mechanism, composed of the Single Resolution Board (SRB) and the Single Resolution Fund (SRF), created a much-needed framework for the resolution of banks.

In 2020 the pandemic crisis tested the EU and euro area’s resilience again. Thanks to a rapid, effective, and well-coordinated cooperation at both national and European levels, the crisis was overcome. The institutions and member states showed a high degree of solidarity.

The ESM also partook in this effort by putting in place the Pandemic Crisis Support credit line. Created to help euro area members countries bear healthcare-related costs, its mere existence reassured markets.

This endeavour was complemented by the European Commission and the European Investment Bank, which respectively supported workers and businesses.

NextGenerationEU, with the Recovery and Resilience Facility as a central component, presented another act of unprecedented solidarity in the EU to help our economies not only rebound but also become greener and more digital.

Finally, the war in Ukraine, beyond the human and material devastation it causes, has exacerbated inflationary pressures and driven up energy prices. But again, the EU acted resolutely. In response to these disruptions in the energy market, it launched REPowerEU, a strategy to wean Europe off Russian gas and oil by expediting the switch to clean energy, preserving energy, and diversifying energy sources.

What we can draw from all this is that institutional innovation and increased solidarity have enhanced the resilience in the euro area and the EU.

Now, can we rest on our laurels? Certainly not.

What remains to be done?

Banking union

There is a pressing need to complete banking union.

Under the second pillar, the resolution pillar, the SRF is expected to reach a bit less than €80 billion by the end of this year. The amended ESM Treaty foresees that, upon its ratification, the ESM will provide a backstop. It would thereby nearly double the resources available and allow all euro area member countries to benefit from an additional safety net. Making progress on this front is important. As we have seen recently, banking turmoil can occur unexpectedly.

Under the second pillar, it is also imperative to manage the failure of medium-sized and smaller banks more effectively. The European Commission recently tabled a proposal in this regard, with the objective to adjust and further strengthen the EU's existing bank crisis management and deposit insurance (CMDI) framework.

However, the lack of specific arrangements to provide liquidity after resolution still is a shortcoming in our architecture. It needs to be addressed.

Finally, progress is needed on the third pillar, the European Deposit Insurance Scheme (EDIS). In the longer term, extending the SRB’s mandate to manage EDIS could greatly contribute to strengthening banking union. Similarly, it would be a natural extension of the ESM’s mandate to include the provision of a backstop to the

EDIS.

Economic governance review

The pandemic necessitated major support measures, which led to a substantive accumulation of debt. This was possible because of the activation of the general escape clause embedded in the Stability and Growth Pact. Such flexibility, foreseen for severe economic shocks, was fully justified. However, it will stop at the end of this year.

Although economic policies did support one another during the pandemic, the current economic environment demands a fresh alignment between monetary and fiscal policies. To prevent compromising the efficient transmission of monetary policy, government expenditure must be kept in check. Similarly, sound fiscal policies are essential to ensure debt sustainability over the medium term.

Reverting completely to the old set of rules would risk choking off growth in some countries, eventually weakening the euro area as a whole. The current review of the economic governance is also crucial in keeping the EU and the euro area on a stable course.

The reformed fiscal framework will have to be based on credible, transparent, and verifiable rules and ensure equal treatment between member countries. It should be based on the clear tenet that any debt consolidation path should reconcile both stability and growth. Both should go hand in hand. This approach would foster ownership and generate superior outcomes.

Finally, the emphasis should be on sustainable growth, as sustainable growth constitutes a strong foundation for stability.

All in all, I think that the European Commission’s proposal is a balanced and good basis for negotiation.

Stability fund

Looking at recent external shocks reminds us that crises can happen outside the control of member states.

And any new shocks occurring now would take place at a juncture where monetary policy is tightening and fiscal space has become more limited.

To increase the euro area's resilience and ability to cushion against such shocks, a stability fund could be created. It is still missing in the euro area architecture. Such an additional instrument could help avoid fragmentation within the euro area. It could address moral hazard by design and have significant stabilisation effects.

Capital markets union

Finally, we need a capital markets union (CMU).

Europe needs to converge towards a true single capital market. Today, fragmented national markets in Europe remain a hurdle for international investors. We need a deep, integrated capital market that allows for increased private risk sharing. Public money alone is not sufficient to finance our ambitions.

In March this year, the Euro Summit conveyed its renewed ambition to deepen CMU. In May, the Eurogroup agreed to a process on CMU and the President on the Eurogroup aims to report back to the Euro Summit in early 2024.

I hope more headway will be possible this time around.

The ESM

To conclude, a final note on the ESM.

When I was appointed Managing Director of the ESM, my first decision was to visit all my shareholders, the euro area member countries. As of today, I have visited 13 of them, with my most recent visit having been Dublin at the beginning of this week.

I have been in listening mode to seek out views on how the ESM can best support its Members. The ESM is mainly known for having supported countries between 2012 and 2018. Since then, its mere existence has been a confidence-building insurance for the euro area. Preventing fires is less costly than extinguishing them. I think this is where the ESM can play a bigger role.

As we have seen, the nature of crises can be manyfold. So, there is a need to adapt, like the International Monetary Fund has been able to do within its mandate.

The input of our shareholders will be key in determining how the ESM will evolve in the future. Based on this input, I will table a non-paper to the Eurogroup, probably in autumn. Stay tuned.

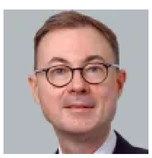
At any rate, I can assure you that the ESM will remain a key component of the euro area architecture.

Thank you for your attention.

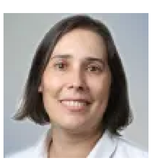
Author

Pierre Gramegna
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