“The euro area: an open and stable economy” - speech by Rolf Strauch

View PDF
30/11/2017
Speeches
ESM
Hong Kong

Rolf Strauch, ESM Chief Economist
“The euro area: an open and stable economy”
ASIFMA Annual Conference
Hong Kong, 30 November 2017

(*Please check against delivery*)

Ladies and gentlemen,

It is a real pleasure for me to speak to you at the EU – Asia Financial Dialogue. The European Stability Mechanism is engaged in this dialogue all the time. As a large fixed income issuer, we continuously talk to Asian investors. And we also work closely together with policymakers here. Fostering this dialogue is close to our heart.

Globalisation is part of our daily life, just as it is for yours. Capital markets operate globally. Capital is allocated most efficiently when borders are open. Your industry stands to gain most if governments resist protectionism, promote cross-border cooperation and harmonise rules.

Europe is equally committed to globalisation. This makes it an attractive and reliable region for your industry. Of course, the financial crisis reminded us that globalisation can also carry substantial risk. But Europe's inclusive economic model offers better ways to deal with such pitfalls of globalisation. Moreover, Europe has become more robust after the crisis. This means that the euro area economy is not only very open. It is also very stable.

In what follows I will first give some evidence that the euro area is more open than other major economies and that it is also competitive. Secondly, I will explain why the monetary union came out of the crisis stronger than before: both economically, and institutionally. Thirdly, I will talk about the reforms on the current political agenda. These are aimed at making sure that also in the future, the euro area remains an open and stable economy.

There are various ways to show that the euro area is the most open major economy of the world. The size of exports plus imports as a percentage of the size of euro area countries, for instance, stood above 80% in 2016. That is by far the biggest contribution of any of the world's major economies. Since 1995, the number has also risen more rapidly in Europe than in the U.S., where it remained largely flat.

Moreover, the euro area countries produce 14.4% of global exports.[1] This is the highest share for any large economy in the world, despite the rapid rise of fast-growing emerging economies. Chinese exports are the second-largest, at 13% of the global economy.

Looking at the financial side of the economy, the euro area also comes out as a strong player. Net international investments show that the euro area has a higher share of global assets compared than any other major region, and is close to the U.S. in terms of liabilities. Euro area investment funds including pension funds hold 27% of global assets.

The openness of the euro area is no coincidence. It was supported very deliberately through European Union policy coordination over many decades. The best proof of European multilateralism are the single market, with its free movement of goods, service, people and capital, and the euro, the single currency of the Economic and Monetary Union. Euro area countries also liberalised their product markets and reduced barriers to entrepreneurship by more than, for example, the U.S. and Japan over the last decades. As a consequence, they have among the most competitive business climate in the world. According to the World Economic Forum, one third of the most competitive 25 economies are located in the euro area. For certain aspects, such as insolvency law and trading, it is even about half of the top group.

This provides a link to my second point: the fact that the euro area economy isn’t just very open. It has also become more stable after the crisis.

European society has shown more solidarity than others in coping with the pitfalls of globalisation. While openness to trade and movement of capital and labour has overall been beneficial, without any doubt, some groups can lose out and face disruption. Europe’s social model has offered these groups a helping hand, which is crucially important for social cohesion and societal stability.

Let me give you some evidence. The recovery in the euro area has put people back to work. Prior to the crisis, demand from workers was a strong driver of growth. The crisis presented a drastic rupture, obviously, especially in those countries where the construction sector broke down. But the employment rate has been rising since then, and is now higher than it was in 2000. In the U.S., the employment rate is still well below the 2000 level.

Another point is that euro area income distribution is much better than anywhere else in the world. Inequality in disposable income of high earners and the lowest income bracket continued to increase in the U.S. during the last decade, but remained broadly stable in Europe. The loss of employment among blue collar workers in the U.S. is one of the plausible explanations for the rise of populism. In the euro area, populism based on anti-globalisation sentiments has been relatively restrained. Europe’s social model is a plausible explanation why. Still, our response to the challenges of migration must become more adequate.

Let me also mention some steps that the euro area has taken to stabilise its economy, and overcome the weaknesses that the crisis brought to light.

The euro area has reformed the common governance framework, and strengthened economic policy coordination. It adopted a Banking Union to break the vicious link between the banking system and sovereigns, which emerged in the crisis. This was also a crucial move towards a common euro area banking market.

In addition, the ESM offers another new tool of financial solidarity between euro area countries. Its predecessor, the EFSF, was set up in 2010 to provide financial assistance to euro area countries that had lost market access during the crisis. Such a crisis resolution institution did not exist in the monetary union. This is because it had been deemed an impossibility for a country to be shut out from fixed income markets once it had adopted the euro.

Having an institution like the ESM has prevented the break-up of the euro, which was a real risk at the height of the crisis. Without the ESM, several countries might have been forced to leave the single currency, which would have caused economic chaos. Something that is often not noticed is that ESM loans also provide substantial budget savings for programme countries. This is because of our favourable cost of funding. In the case of Greece, we have calculated these savings amount to €10 billion per year, or 5.6% of the country's GDP. Providing funding at such favourable conditions is a strong sign of solidarity among euro area countries.

ESM loans have enabled programme countries to reform their economies during the crisis, and to regain the trust of investors. We have provided loans to five countries. Four of these five are now success cases: Spain, Portugal, Ireland and Cyprus. They display among the highest growth rates in the euro area, and they are also the countries that have reformed their economies the most. And so, the ESM programmes were a crucial help to stabilise the euro area economy after the crisis.

Let me finally outline the reforms that are on the political agenda, and with which Europe will aim to ensure that the economy remains a haven of competitiveness and stability.

Europe should strengthen further its growth potential. Structural reforms need to continue in all countries, not just in those who received an assistance programme. Strengthening production factors is important for the long-term convergence of the euro area economies. There is good evidence that this requires a better functioning of product markets, high quality education systems, flexible labour markets, and strong financial supervision.

Another gap that the euro area needs to fill is economic risk-sharing. The comparison with the United States is telling. It shows that euro area countries are to a much lesser extent able to smooth economic downturns than inside the U.S.

Moreover, important channels of risk-sharing are less developed. For U.S. states, capital market flows help to weather economic fluctuations.

There are a several policy steps which can be taken at the European level to improve these channels of risk sharing. This discussion has started, and we expect it to lead to decisions on the deepening of EMU by mid-2018
First, Banking Union needs to be completed. Banking Union was launched with the creation of a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM). The Single Resolution Fund needs a financial backstop to make it more credible. This is a role that the ESM could take on. Europe also needs a common deposit insurance. This can happen only after legacy issues at banks in a number of countries have been tackled.

Secondly, the euro area should strengthen its common capital market. This requires to harmonise bankruptcy, tax and corporate law and move towards more a more harmonised capital market supervision. This would ease the way for cross-border equity investments and open up new ways of funding for companies. Over time, it would also reduce their heavy reliance on bank funding, one of the sources of the crisis. Finishing the Banking Union and setting up the Capital Markets Union would be a major step to increase risk-sharing in the monetary union.

There is also a political debate about simplifying the EU fiscal rules. The rules have been tightened since the crisis, but they are now too complex. So I welcome the debate on how to make them more effective that has now started. Better rules would help to create the fiscal space needed in future recessions.

Another step is the completion of the fiscal instruments available at the European level. In my view, we have a real need for a facility that deals with asymmetric economic shocks. A country hit by an asymmetric shock would receive money during a crisis, but would need to repay it once it recovers. This is possible without permanent transfers between countries, or debt mutualisation, for instance in the form of a U.S.-style rainy day fund, or a complementary unemployment scheme.

There are also now plans to transform the ESM in a European Monetary Fund. The role of the IMF in the euro area assistance programmes has gradually declined, at least financially. In any future crisis, it seems unlikely that the Fund will again participate. The ESM would then run these programmes together with the European

Commission.

Together, these reforms may sound like a long list. But they are moderate and manageable compared to the comprehensive policy response that the euro area took after the euro debt crisis that started in 2010.

All these steps are will further cement the stability of the euro area and the openness of the European economy. This has been a successful recipe for many decades, as I have tried to show in my remarks.

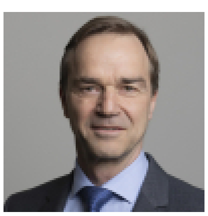
Euro area citizens appreciate this recipe. The popularity of the single currency is at record heights: three-quarters of the euro area population support the euro.

That is phenomenal recognition of the policies that have made the euro area what it is today: an open and stable economy. It also provides politicians with a strong mandate to continue along the path which will ensure this remains the case in the future.

[1] Total exports of euro area countries, including intra-euro area trade, amount to 25% of world exports.

Photo credit: ASIFMA and Afore Consulting

Author



Rolf Strauch
Chief Economist and Management Board Member

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