Where does Europe stand? Rising national debt and its consequences for Europe - speech by Pierre Gramegna

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Pierre Gramegna, ESM Manging Director
Speech at the German Association in Luxembourg
“Where does Europe stand? Rising national debt and its consequences for Europe”
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Dear Mr Werner,

Dear Ladies and Gentlemen.

I am a convinced European. Close cooperation among EU countries is essential for a strong Europe. This also includes German-Luxembourgish cooperation.

We need a strong Europe to overcome the challenges ahead – that is beyond question.

I: Looking back

Solidarity was the guiding principle that led to the creation of the euro rescue fund ESM (European Stability Mechanism) more than ten years ago. Some of you may still remember the euro crisis, as well as the uncertainty that prevailed at the time. Back then, the question was whether the euro area would break apart.

In response to this, the first temporary rescue mechanism, the EFSF, was established, followed soon after by the second permanent mechanism, the ESM. The waves of that time have calmed down.[1]

The countries that benefited from reform plans and financial assistance from the ESM at that time – we are talking about a total of around €300 billion – are now the growth engines of the euro area. Other countries have temporarily slowed down. The situation has changed in many ways.

That is the question this evening: Where does Europe stand?

My special thanks go to you, Mr Werner, for the invitation. I am pleased to have the opportunity to talk for the next 20 minutes about the risks and challenges I see for Europe. I will delve into the topic of the debt situation in Europe.

National debt and consequences for Europe

Debt is a link between the past and the future, both for households and for the economy. Governments use debt to address problems and shape the future through investment. At the same time, however, debt can also cause crises and stability risks – which is particularly important for the ESM.

The COVID-19 pandemic led to an increase in debt levels worldwide. This is not surprising. In times of crisis, debt often increases as governments (and institutions) need additional funds to address economic and social challenges.

Subsequently, it is important to reduce the debt again. This has worked better overall in Europe than in other regions. When we look back over the past few years, we see that Europe has shown resilience. Compared globally, Europe has handled debt responsibly.

Considering debt levels in relation to economic strength, debt in the USA has risen from almost 110% before the pandemic to around 120% last year; in China, from 60% to 90%, which means an increase by half. Among the industrialised countries, Japan has the highest debt burden. Here, debt has risen from almost 240% to around 250%. The International Monetary Fund (IMF) assumes that global debt levels will continue to rise on average in the coming years.

How is Europe doing?

In the European Union, the debt level before the pandemic was almost 80% of GDP, then it jumped to around 90% and is currently at 83%.[2] This means that despite the energy crisis, the EU is the only region approaching pre-crisis levels. This is an effect of the economic recovery as well as the high inflation in recent years.

However, it would not have been possible to manage debt and ensure economic stability without the willingness of member states to phase out financial support measures. Although Europe has managed its finances well compared to other major economies, not everything is fine.

Countries have different fiscal and political leeway. Some countries – such as France, Italy and Spain – are still heavily indebted and also have relatively high deficits.

II: Europe's instruments to meet challenges

The coming years will be challenging for Europe.

Different fiscal starting positions mean that not all countries are equally resilient and able to invest for the future. Countries with high debt and deficits have less room to respond to economic crises or to invest in important areas such as education and infrastructure. Other countries have more fiscal space and can better prepare for the future through investments that are good for competitiveness.

It is especially important now to build up fiscal buffers and stimulate growth. Our strong fiscal framework and the ESM as a safety net are strong foundations. I welcome that Europe has agreed on a reformed Stability and Growth Pact that takes these aspects into account. The EU fiscal rules play a crucial role in ensuring sound public finances within the European Union. The fiscal framework should now be implemented; it places a stronger focus on investment and grants countries more time.

It is also essential that the ESM is prepared. The ESM's mandate is to ensure financial stability in the euro area. The ESM has firmly established itself within the framework of European institutions.

The ESM is equipped for the future: it has a financial firepower of €500 billion.[3] Currently, we have €427 billion that we can lend. This is an impressive “insurance policy” for the euro area.

At the same time, it is important that we remain flexible and ensure that our financial assistance instruments are suited to different types of crises. We have demonstrated this during the pandemic and are striving to do so now.

Member states initiated a revision of the ESM Treaty, which assigns us a new role in crisis management, especially for the banking sector. This should now be implemented.

We have reviewed our financial assistance instruments and now need to see how our precautionary instruments can play a greater role in strengthening the future resilience of the euro area, considering Europe's long-term challenges. We are currently working on concrete proposals for how this can be practically implemented.

III. Europe's long-term challenges

At the ESM, we have identified three megatrends that will determine Europe's future growth, debt sustainability and thus our financial stability over the long term:

1. The effects of climate change
2. Demographics and the implications of an ageing society
3. Geopolitical fragmentation

What can the ESM do? What are the possible solutions?

Climate change – the first megatrend – is leading to an increase in natural disasters worldwide. One example is the flooding in the Ahr Valley in the summer of 2021.

Luxembourg was also affected at that time. I am also thinking of the recent floods in Valencia and the devastating fires in Los Angeles.

There is a gap between overall economic and insured damages. In Europe, according to EIOPA,[4] only a quarter of the damages from 1980-2021 were insured. When insurance is lacking, it is usually the case that the costs of the damages are passed on to the state.

Therefore, the ESM has proposed closing this gap with the help of an EU-wide insurance fund for climate disasters.[5]

To tackle climate change, we need appropriate regulation and measures to reduce and adapt to climate risks. Europe can help here – especially through the Savings and Investment Union.[6]

The second megatrend, population ageing, is a trend that now affects all countries with varying intensity. In some countries – including Germany and Italy – the working-age population is already shrinking. In other countries – like France or Spain – this trend will only become noticeable in a decade.

But in all countries, ageing tends to lead to lower growth due to lower demand, fewer workers and less innovation, and increased costs for the public sector. Ageing is a key factor for future debt sustainability, and it is up to the Member States to implement the necessary reforms. Much has already been done, but further adjustments in pension systems will be necessary.

Europe can help. The idea of a Savings and Investment Union aims to bring more Europeans into the capital market. Savers should be able to achieve better returns on their savings, and companies should get better financing conditions. Three things reduce the burden on national governments: privately funded pension schemes, corporate financing, and growth. Of course, such steps must be taken with great caution – consumer protection, regulation and proper financial education play a crucial role. At both the technical and ministerial level, the ESM strongly supports the work on the Savings and Investment Union.

The third megatrend, geopolitical fragmentation, is now of primary concern and requires more external strengthening.

Europe is indeed a peace project, but recent events have shown us that peace is not a given. We need to rethink Europe's defence and security. Enrico Letta suggests in his report “Much More Than a Market” that the ESM could establish a credit line to help euro area countries finance their defence and security expenditures.

In regard to this proposal [that the ESM set up a credit line for defence and security spending], there would need to be consensus among the 20 euro area member states that defence and security issues pose risks to financial stability. Then the ESM would be able to help.

IV: Immediate future in the geopolitical context

In the current international context, multilateralism – particularly on trade issues – is being challenged, notably by newly appointed US President Trump, who was sworn in yesterday.

When it comes to trade openness, it quickly becomes clear that the EU, compared to the US and China, would be the biggest loser in a trade war.[7]

In the coming days and weeks, we will gain more clarity, but it is assumed that European growth will suffer under the new course of the US government.

Our economic size on the global stage is already clearly behind the US and China.[8] Additionally, the US has grown twice as much as the EU in the last five years.[9]

This means for Europe: we must ensure our economic security and long-term competitiveness in a fragmented global economic system. To do this, we must strengthen the European single market further. This is also emphasised in the report by Enrico Letta.

A study by the IMF shows that we would gain 7% of EU growth if we reduced trade barriers within the EU single market by 10%.[10] We need a better-functioning EU single market to finance the necessary investments. We also need it for energy security and to reduce our dependence on external trade flows.

At the same time, productivity in the EU, which plays a role in competitiveness, is also lower than in the US.[11] Mario Draghi clearly emphasised this in his report on European competitiveness. Looking at a longer period, one notices: it is a problem that has not only existed for five years, but for 30 years.

Strengthening Europe

There is still much to be done in Europe. Let us focus on the areas we can influence the most.

First, fiscal discipline and national reform efforts ensure sustainable debt levels. Investments in technology and innovation create new jobs and improve long-term growth.

Second, European initiatives can promote growth and support national efforts by using funds more efficiently and creating a larger internal market.

Third, despite these efforts, we will continue to face conflicts and risks from the global economic and financial system or political tensions.

Crisis resilience remains important to jointly ensure our economic stability. The ESM will contribute to crisis prevention, particularly the precautionary credit lines of the ESM can play a role here.

Conclusion

Allow me to conclude here. I am a convinced European. For me, it is clear: if Europe wants to overcome future challenges, it needs more, and certainly not less Europe.

Those who commit to Europe commit to shared responsibility. We particularly need this shared responsibility in view of the current world situation, but also to tackle rising national debt. Sustainable public finances are the foundation for a sustainable and stable economic future for Europe. We must work together for a strong Europe.

Thank you for your attention. I look forward to a lively discussion.

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[1] European Commission (2024), Eurobarometer: “Today, eight out of ten respondents living in the euro area believe that the euro is a good thing for the EU.”

[2] Data on debt from International Monetary Fund.

[3] Maximum lending capacity.

[4] European Insurance and Occupational Pensions Authority.

[5] European Stability Mechanism (2024), Broadening the scope of risk sharing through a European backstop for natural catastrophes | European Stability Mechanism.

[6] Formerly called Capital Markets Union.

[7] International Monetary Fund (2023), Trade openness (goods and services) in % of GDP: 57.4% euro area (excluding trade among euro area countries); 34.3% China; 25.8% USA.

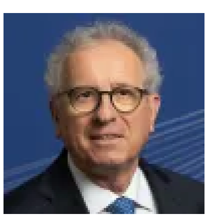
[8] International Monetary Fund (2024), GDP at current prices (billion US dollars). A rough calculation shows that the EU grew 2.7 times, the US 4 times, and China approx. 32 times in the last 30 years – although the catch-up effect of China should not be ignored.

[9] International Monetary Fund (2024), real GDP growth rate, actual and projected, 2020-2024. Compared to 2019, EU GDP grew by 6% by 2024, while US GDP grew by 13%, more than twice as much as the EU's.

[10] International Monetary Fund (2024): Geoeconomic Fragmentation: What's at Stake for the EU; Europe: Turning the Recovery into Enduring Growth

[11] Eurostat (2024), labour productivity (per person), 1995-2024. EU is at 130, USA is at 160.

Author



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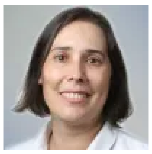

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