"The role of the ESM in a deepening EMU" - speech by Klaus Regling

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"The role of the ESM in a deepening EMU"
Ljubljana, 2 February 2018

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Ladies and gentlemen,

Many thanks for inviting me to this conference. It is good to be back in your beautiful country. I like this corner of Europe.

Slovenia adopted the euro in 2007, the first Eastern European country to do so. I worked at the European Commission at that time. Later, I met Slovenia again, this time as a shareholder of the EFSF, the institution I've managed since its inception.

It is a great pleasure to speak after Maarten Verwey. Not everybody may know that he was instrumental in creating the EFSF early in 2010. At that time, the survival of the euro was at risk. Europe had to fight two crises, first the global financial crisis, then the euro crisis.

The global financial crisis affected many parts of the world. But the euro crisis brought to light a number of design flaws in the monetary union. Politicians fixed the most crucial of those with a set of institutional innovations, many of which would have been unthinkable just a few years ago.

The establishment of the Single Supervisory Mechanism and the Single Resolution Board, the first two pillars of Banking Union, are a very clear example.

The ESM is another key innovation. It is a lender of last resort for euro area countries, a function that was not part of the initial set-up of EMU. Together with its predecessor, the EFSF, it has disbursed a total of €273 billion in loans to five countries: Ireland, Greece, Portugal, Spain and Cyprus. Four out of these five are now success stories. They have ended their programmes, and their growth rates are among the highest in the euro area.

Greece’s current programme runs until August, and the country can also make a successful exit, if it continues to implement the reforms that are part of the programme.

The crisis is now firmly behind us, and the economy expanding again. This period of calm gives us some breathing space. Some time to think about how to make the euro area function better, and how to make it less vulnerable when the next crisis hits. This is our topic today. There is a broad debate about how to make monetary union more robust. In December, Europe’s political leaders mandated work on a concrete agenda to deepen monetary union further. I believe an agreement is possible by June, even if the debate is controversial.

President Donald Tusk asked finance ministers to work first on the areas “where the convergence of views is the greatest” – namely completing Banking Union and developing the ESM. In my remarks, I will mainly talk about the second topic. I will leave it to Benoit Coeuré to look in more detail at the Banking Union, and Maarten has already addressed ideas for fiscal measures.

On Banking Union, let me just say that completing it would make the euro area work better and financially far more robust. The two elements under discussion here are a backstop for the Single Resolution Fund and a common deposit insurance scheme. A credible common deposit scheme would reduce the risk of national bank runs in a future crisis.

Before any of this can become operational, problems in banks that are a legacy of the crisis need to be sorted out. I hope that the June summit can adopt a package to complete the Banking Union, with clear steps to reduce risks, on the one hand, and a timetable to launch the common backstop for the SRF and move towards a common deposit insurance, on the other hand.

Now let me turn to my main point, the possible development of the ESM. A stronger, more powerful ESM is not a goal in itself. But it can be an element to make monetary union more robust and for Europe to take on more responsibility to solve our own problems. Let me look at the options that are on the table. A first likely new role the ESM could take on is that as a backstop for the SRF.

There is also a growing consensus among the euro area countries that the ESM needs to prepare for a bigger role in assistance programmes, as the IMF may participate less in the future. Europe couldn’t have done without the firepower of the IMF in 2010, nor without its expertise, but that has now changed. The ESM has sufficient lending capacity and its own know-how and the European Commission has gained a lot of experience. This is also reflected in the fact that IMF disbursements have become ever smaller: from around a third of the loans at the start, to just 10 percent in the second Greek programme and in Cyprus, and no contribution so far in the current Greek programme. A possible withdrawal of the IMF also has to do with criticism from its non-European members, who hold 70 percent of its shares, and who have at times been unhappy with the Fund’s heavy involvement in Europe.

Taking the crisis experience into account, designing, negotiating and monitoring an adjustment programme, and the conditionality that is at its core, should become a joint task of the Commission and the ESM. The ECB still has to clarify its own position in this context. Developing the mandate of the ESM as a crisis resolution mechanism would build on the fact that it has matured over the last five years. Initially, the ESM – like the EFSF – was mainly in charge of mobilising and distributing cash. But in recent years, particularly in Greece, the ESM has been more and more involved in providing economic, financial and policy advice, both in the context of the programmes and our early warning system. A new mandate should focus on the effectiveness and efficiency of its support to help a country regain market access at sustainable conditions, complementing the indispensable work of the Commission.

But that would not give the ESM a role in economic policy coordination in Europe or in the implementation of the Stability and Growth Pact, nor the Macroeconomic Imbalances Procedure. Here, this prerogative of the Commission is fully preserved by European law. I am sure the ESM and the Commission will be able to agree on an efficient cooperation framework, respecting their legal remits.

Another possible task for the ESM could be to provide new facilities, such as a macroeconomic stabilisation function. These could work through shorter-term ESM loans, to be repaid within a cycle, with a lighter conditionality than in regular programmes. The loans could also serve to stabilise investment, or reward structural reforms.

Furthermore, the ESM could play a role if member states were to define more clearly a Sovereign Debt Restructuring Framework to make settlements with private creditors more predictable and transparent. The framework should, in my opinion, not contain any automatic extension of maturities, while Collective Action Clauses could be improved to prevent lengthy hold-out battles. If Europe were to agree to introduce such a framework, the ESM could provide the debt sustainability analysis, and help organising negotiations between creditors and the debtor, with the aim of a fair solution for all stakeholders.

With such added tasks, the ESM's role would become more similar to the IMF. Many people have suggested that "European Monetary Fund" would then be a better name for our institution. But this might cause confusion, because we will continue to refinance our lending operations in the market – and not in any monetary way. In my view the name "European Stability Fund", or ESF, could therefore be more appropriate for an ESM with a more developed mandate.
As a last point on the future of the ESM, let me say that I am fully in favour of integrating it into the EU Treaty. But Article 352, the legal basis of the Commission proposal, raises numerous questions.

The model that I foresee for the integration of the ESM into the EU-framework is along the lines of the European Investment Bank, a body with its own capital - independent from the EU budget – and accountable to its shareholders. For this to happen, the ESM Treaty and the EU Treaty would need to change.

That concludes my remarks on the future of the ESM. Several fiscal issues are also on the agenda: from simplifying the fiscal surveillance framework, to creating a euro area budget, or adding euro are lines to the EU budget, a macroeconomic stabilisation function, promoting investment, and the question of a euro area finance minister. These issues will probably take more time. What is most urgently needed, in my view, is a macroeconomic stabilisation function, which could come in the form of a revolving fund, possibly through a new, dedicated ESM facility.

Ladies and gentlemen, we are asking ourselves the question today if Europe is ready for the next crisis. Although we have come a long way, we still need to deepen monetary union a bit more before we can truly answer this question with a “yes”. Europe has a good chance to make progress, and create a more robust monetary union.

Even if the last crisis seems only a short while away, there will be another one. Deepening monetary union is the best guarantee to make sure Europe is prepared when that moment comes.

Thank you for your attention.

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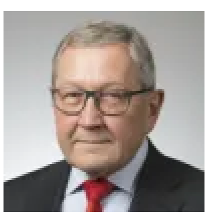

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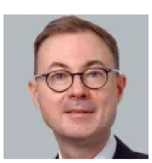

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