

“The ESM’s role in deepening monetary union” - speech by Klaus Regling

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Klaus Regling, ESM Managing Director

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Ladies and gentlemen,

Thanks for inviting me to speak about deepening the monetary union. This topic is very close to my heart. Not just because it concerns the ESM. But also because there are good economic reasons to make the euro area more resilient still. Much repair work has been done during the euro debt crisis. Now we should complete that work. The economy is doing well, and a consensus is growing among the euro area countries about the next steps to deepen monetary union. Don’t get me wrong: I don’t think the next crisis is around the corner. But it will come one day. And that is why we should prepare ourselves as well as we can.

The European Commission’s proposal of last December consists of a comprehensive package, which includes proposals for the completion of the Banking Union and a

future European Monetary Fund. In my view, a lot of this package goes in the right direction, though there are also things I disagree with.

I would like to focus on the two topics where convergence of views has progressed the most. Completing the Banking Union and developing the ESM are the two elements president Tusk asked finance ministers to work on in December. Fiscal issues are a third element, but there is a higher divergence here. Political leaders will discuss these topics at a summit tomorrow and Friday, and then again in June.

Let me first look at the Banking Union. Its creation was an essential part of Europe's crisis response. The Single Supervisory Mechanism and the Single Resolution Board are crucial to make euro area banks more robust, and to protect taxpayers in a next crisis. To complete the Banking Union, we still need a backstop for the Single Resolution Fund, and a common deposit insurance. This would foster financial integration, boost economic risk-sharing, and make the euro area economy more resilient.

There is a growing consensus that the ESM should play the role of a backstop for the SRF. But there is work to be done before we can introduce the other step: a common deposit insurance. Profitability in Europe's banking sector is disappointingly low. U.S. banks have simply been faster to deliver higher returns after the crisis. This is explained by overbanking in some countries, outdated business models in some cases, and in particular by the high stock of non-performing loans.

It is true that NPLs are well-provisioned, and decreasing. But they remain too high, especially in some countries. The volume of sovereign bonds on the balance sheets of some banks is also very large. Insolvency regimes differ significantly among member states. I hope it will be possible to find the right balance between risk-sharing and risk reduction. Because a common deposit insurance across Europe would contribute to financial stability and so make the monetary union less vulnerable.

Let me now turn to the development of the ESM. My institution has substantially matured since its inception. We were always in charge of financing the programmes, and disbursing loans. This has given us considerable market intelligence capabilities. Over the years, we have taken on several new tasks. We are now more closely involved in the design of the financial aspects of the programmes. We monitor

whether former programme countries are able to pay back their loans with our so-called Early Warning System. And the debt sustainability analysis of the ESM is state-of-the-art.

The ESM is ready to take on new tasks. Of course, a stronger and more powerful ESM is not a goal in itself. But – like completing the Banking Union – it can be one element to make the monetary union more robust. When I listen to the discussions between the euro area countries, I sense a broad support to develop the ESM's mandate. Some even say that we should be a European Monetary Fund. But in my opinion, we should not waste too much energy thinking about a name. Let's focus on substance instead.

I already mentioned the first likely new mandate for the ESM, which is a backstop for the SRF. Secondly, we could take on a greater role in new assistance programmes. Over the years, the IMF's financial contributions have become ever smaller. In the third Greek programme, it has not yet taken part financially. And as the IMF gradually withdraws, the ESM could in the future design, negotiate and monitor new assistance programmes together with the European Commission. Of course, this cooperation must fully respect the legal competences of both institutions, and avoid any overlap. The ESM and the Commission have already started working on a framework to set out what this cooperation would look like.

The ESM could also run a new fiscal facility, such as a macroeconomic stabilisation function, if Europe decided to put this in place. Shorter-term ESM loans could help stabilize investments, reward structural reforms, or contribute to macroeconomic stabilisation in general. Such ESM loans should be repaid within a business cycle and would have nothing to do with permanent transfers between countries.

Finally, the ESM could also play a role if euro area countries were to define a sovereign debt restructuring framework, to make settlements with private creditors more predictable. The ESM could provide the debt sustainability analysis, and organise negotiations with creditors, along the lines of the London Club. This should not include any automaticity, however, such as an automatic extension of debt maturities, which could have procyclical effects.

A final point on the ESM is about its legal status. I have always been in favour of integrating the ESM in the EU Treaty, but I believe that this cannot be done through

secondary law. A change of the EU Treaty would be required to give the ESM a status like the European Investment Bank, a body clearly anchored in the EU Treaty, with a protocol, its own capital and accountability to its shareholders. Therefore, the ESM should continue as an intergovernmental body for a while. But when we do change the ESM Treaty, we could insert the clear objective of integrating the ESM into EU law when the next Treaty change happens. In addition, I would be happy to continue to work under an inter-institutional agreement, but with a formal cooperation with the European Parliament rather than the informal one we have had for the last few years.

Ladies and gentlemen, it is time to complete the work of making the monetary union more robust and less vulnerable. The issues are well identified. In the next few months, our governments should act.

Thank you for your attention.

Author



[Klaus Regling](#)

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