"A European Monetary Fund: for what purpose?" - speech by Klaus Regling

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Ladies and gentlemen,

I am very pleased to speak at this conference. The Euro 50 Group, as always, has succeeded in putting together a programme that is very relevant for the current policy debate. The discussion about the political situation in Italy we just listened to clearly shows that.

This first session deals with a European Monetary Fund (EMF), one of the key proposals in the debate about deepening EMU. I will give you my perspective on how developing the ESM into a more complete crisis resolution mechanism could make the monetary union more robust. A more developed ESM may - or may not - be called EMF. For me, substance is more important than a name. Legal and governance issues are, however, important, and I will return to that point.

The ESM has matured substantially since its inception. The EFSF, the ESM’s predecessor, was set up as a temporary solution in 2010, and was not meant to be used at all. Its initial function was that of a cash machine to raise money and disburse loans to programme countries. Now eight years later, the ESM - a permanent institution - has built up a strong track record of achieving results. Four of the five countries that received EFSF or ESM loans have successfully ended their programmes, and have among the highest growth rates in the euro area. Our task of financing the programmes has given us considerable expertise operating in financial markets, and analysing them. Last year, EFSF and ESM issued 61 billion euros in bonds. The complex and highly technical work on the short-term debt relief measures for Greece, which we implemented last year, is another example of our market activities. Over the years, we have taken on additional tasks. The ESM is now more closely involved in the design of the financial aspects of programmes. We monitor whether former programme countries can pay back their loans with our so-called Early Warning System. And the debt sustainability analysis we have provided for programme countries is state-of-the-art.

At the same time, Europe has come to rely less on the IMF. At the start of the crisis, the Fund was needed not only for its financial firepower, but also for its broad experience with assistance programmes. Over the years, the financial contributions of the Fund have become gradually smaller. The IMF contributed one-third in the beginning of the crisis, but only one-tenth in the second Greek programme. In the current Greek programme, it has not made any financial contribution so far. We also know there is criticism inside the IMF, from its non-European members, who say that the Fund has been too active in Europe. Consequently, Europe may not be able to count on the IMF to the same degree as in the past.

Therefore, it seems reasonable that the ESM and the European Commission in the future will be jointly responsible for designing, negotiating and monitoring assistance programmes. Of course, this needs to happen with full respect to the competences of both institutions as laid down in the Treaty, and without any overlap. I have no intention of taking competences away from the Commission. But in order for the ESM to be ready to act at short notice when financial assistance is requested, we need to be able to regularly monitor the economic situation in all euro area countries, and not just the current or former programme countries.

Let me be clear that this would not give the ESM a role in the economic policy coordination under the Stability and Growth Pact or the Macroeconomic Imbalances Procedure, which is entrusted to the Commission. The ESM and the Commission have already started working on a framework to set out what this future cooperation could look like.

With a more prominent role for the ESM, the institution could also be given other mandates. But a stronger, more powerful ESM is not a goal in itself. What we should try to achieve is a more robust monetary union, with a more resilient economy.

What is needed to reach that objective? The main shortfall that the euro area still needs to fix is a lack of economic risk-sharing, which is underdeveloped compared to the U.S., but also compared to risk-sharing within large European countries such as Germany and France. Risk-sharing takes place through two channels: the market channel and the fiscal channel. The more risk is shared through banks and markets, the fewer fiscal mechanisms are needed. Promoting financial integration, particularly by moving towards a capital market union and a fully developed banking union, is therefore an important goal, as it would promote private sector risk-sharing. On the public sector side, a limited fiscal capacity for macroeconomic stabilisation - without creating permanent transfers – would make sense.

From that analysis, one can derive a number of new functions for the ESM. The first is a financial backstop for the Single Resolution Fund (SRF), so that it is better prepared for a big crisis. The SRF’s war chest will reach its final level of 55 billion euros in 2023. A backstop that would roughly double that amount through an ESM credit line of about the same size, seems reasonable.

The ESM could also provide a limited fiscal capacity for the euro area for the purpose of macroeconomic stabilisation. Shorter-term ESM loans, to be repaid within a business cycle, and with a lighter conditionality than our regular programmes, could help tackle small crises to prevent a bigger one. Of course, other tools could achieve the same objective, such as a rainy day fund or a complementary unemployment insurance. Risk-sharing would really be promoted if the financing of common public goods were to happen via corporate income tax. From an economic perspective, these are all very good ideas, but there is less political consensus about them. And therefore, a shorter-term ESM facility might be easier to implement.

Another possible new mandate for the ESM is managing a sovereign debt restructuring framework to make rescheduling negotiations with private creditors more predictable. I call this a “framework” and not a “mechanism” because it would not include strict rules, such as an automatic extension of maturities, which would be pro-cyclical. The ESM could be the moderator between creditors and the country concerned, along the example of the London Club, to achieve an outcome that is fair for everybody.

So far my thoughts about what a future EMF could look like, and, more importantly, why it makes economic sense. Many of these thoughts were first mentioned in the Commission's comprehensive proposal for deepening monetary union of December, which contained many good ideas, and provides an excellent basis for the current debate.

There are also things I disagree with. I have always been in favour of incorporating the ESM into the EU Treaty, but I don't believe the legal basis the Commission is proposing – secondary legislation via Article 352 - is the right way. The model that I prefer - for reasons of the efficacy and independence of the ESM - is that of the EIB, a body that is clearly anchored in the EU Treaty, but with its own protocol, its own capital and accountability to its shareholders. For this to happen however, the EU Treaty would need to be changed, which is not possible at the moment. Therefore, the ESM should continue with its intergovernmental set-up for a while. An amended ESM Treaty could clearly state the objective of integrating the ESM into the Community framework via primary legislation as soon as possible. In the meantime, I could imagine an intergovernmental agreement between the European Parliament and the ESM, to formalise my regular appearances at the European Parliament.

Ladies and gentlemen, let me come to a conclusion. The title of this conference is: "Seizing the Momentum for Strengthening the EMU". I see widespread support for our efforts to deepen the monetary union. The paper by 14 leading economists from France and Germany that came out in January is a good example. And Markus Brunnermeier's excellent book "The euro and the battle of ideas" argues convincingly that Europe must look for common ground to overcome its problems – despite differences in national traditions and political views that have developed over centuries. It is equally encouraging that support for the euro is at the highest level since 2004 among the citizens of the euro area.

In December, it looked as if Europe was doing exactly that: seizing the momentum. But only four months later I'm not so sure anymore. We seem to be losing the momentum, rather than seizing it. Let me explicitly warn here against the risk of political inaction. Countries need to understand that the current reform agenda is a package. One should not look at its individual elements in isolation.

No country will get all that it wants - but each country will get something. For that to happen, national traditions and convictions will have to meet somewhere in the middle. That is how Europe works. If countries can’t agree on this package, we risk having to wait for the next crisis. Then, the changes we are debating now would be inevitable. But they would happen under extreme time pressure, and probably at greater cost.

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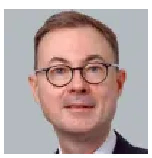

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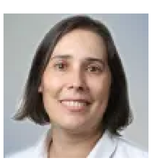

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