The ESM in a robust Monetary Union - speech by Rolf Strauch

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“The ESM in a robust Monetary Union”

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Dear ladies and gentlemen,

Dear Professor Forni,

It is a pleasure to speak here today. Italy is a founding member of the EU. The Treaty establishing the European Economic Community (EEC), was signed in Rome in 1957. Since then, the Italian government has been the depositary of the subsequent treaties, including today’s EU Treaties. These documents form the foundation of today’s resilient yet adaptive Union.

I will dedicate my time to discussing three topics outlining the role of the ESM in a robust EMU:

- Firstly, the role of the ESM in fighting the crisis.

- Secondly, the role of the ESM in further strengthening the currency union.
- Thirdly, the way forward.

Overcoming the crisis

The euro area has recorded strong growth for last three years. Debt levels have stabilised or decreased and budget deficits have fallen. The high current account deficits – that contributed to the crisis – have largely disappeared. That is a remarkable achievement for the monetary union, given that it recovered from the most severe crisis in its existence.

The ESM was a key contributor to overcoming the crisis and bolstering the recovery of countries having experienced extreme economic and financial difficulties. The euro area in its present form would not have survived the crisis without the ESM. Of course, the ESM could not have solved the crisis on its own. European leaders came up with a comprehensive policy package to fight the crisis, which contained five elements:

First, all euro area countries implemented far-reaching structural reforms. Programme countries in particular consolidated their budgets and aligned their competitiveness with the euro area average.

Second, economic and budgetary coordination and surveillance at the European level has been improved and broadened.

Third, the European Central Bank (ECB) stabilised the euro with its unconventional monetary policy.

Fourth, the Banking Union was created: the Single Supervisory Mechanism (SSM), which oversees systemically important banks and the Single Resolution Mechanism (SRB), which, in an emergency situation, resolves banks.

Fifth, the crisis resolution mechanisms were founded. In 2010, the temporary European Financial Stability Facility (EFSF) was created and two years later, the permanent crisis resolution mechanism, the European Stability Mechanism (ESM).

Before the creation of the two mechanisms, there was no "lender of last resort" for euro area countries. Because the European Central Bank (ECB) is the lender of last resort for euro area banks, but not for Member States. Thus, the mechanisms closed an institutional gap in the architecture of the Monetary Union.

The ESM uses the principle of the International Monetary Fund (IMF): loans are linked to strict conditionality. This means that they will only be paid if the programme country implements the reforms agreed in its ESM program.

These reforms are often difficult to implement, both for the citizens and for the government. But they are necessary to restore competitiveness and regain investor confidence.

The ESM gets the money for its loans by regularly issuing bonds. It is one of the largest euro denominated bond issuers among the international financial institutions. The programme countries must repay their loans in full with interest. Contrary to what is often said, ESM programmes do not directly use taxpayers' money.

Since 2011, five countries received around € 280 billion financial support: Greece, Ireland, Portugal, Spain and Cyprus. This means we still have an unused credit capacity of around € 400 billion.

Four of the five programme countries today are economic success stories: they can once again finance themselves on the market, unemployment is rapidly falling and their economies are among the most dynamic in Europe. Greece is due to exit the ESM programme in August 2018 and could then become the next success story of the euro area recue programmes. These successes are important reminders that economic reforms pay off not only in the very long-run. They show what can happen if countries seize the room for improvement.

Further strengthening the currency union

The good economic situation combined with the political will to deepen the Economic and Monetary Union (EMU) gives a unique window of opportunity to further strengthen the currency union, make it more robust and functioning better.

A lack of risk-sharing in the euro area is making it harder to deal with problems in individual countries. Economic difficulties affecting the euro area as whole can be addressed by monetary policy. However, this option does not exist when individual countries are hit by a downturn. The euro area would be more robust and operate more smoothly, if these downturns can be buffered through risk-sharing. Risk-sharing is underdeveloped in the euro area as a whole when compared with the United States or large euro area countries, such as Germany or France.

Risk-sharing can take place through income flows and market interactions in the private sector – mainly banks and financial markets. It can also take place through fiscal tools. The more risk countries share through the private channel, the less need there is for fiscal support.

The lack of risk-sharing through the private channel derives from a lack of fully integrated European banking and capital markets. But we can form truly European wide banking and capital markets by completing the Banking Union and setting up the Capital Market Union (CMU).

The way forward

In December 2017, Council President Tusk invited the ministers of the Eurogroup to give priority to two areas of deepening the EMU: completing Banking Union and further developing the ESM.

For the Banking Union this implies that the Single Resolution Fund (SRF) needs a common backstop. It also implies a European Deposit Insurance Scheme (EDIS). EDIS is the last building block that would complete the Banking Union. EDIS would help overcome the fragmentation of financial markets by unifying them into a single European financial market.

Since last December a lot of work has been done on these two issues. That is why leaders agreed at the Euro Summit to work on a roadmap for political negotiations on EDIS. To make the Monetary Union more resilient, leaders also agreed that the Eurogroup can develop a broader mandate for the ESM. In the future the ESM could be assigned the following responsibilities:

First, the leaders agreed that the ESM will become the financial backstop to the SRF. The ESM could provide a revolving credit line to the SRF about the same size as the ESM’s own funds. If the SRF ever uses this credit line, the SRF would have to repay this money through contributions from European banks. The backstop should be fully operational at the latest in 2024. This timeline can be advanced provided that sufficient risk reduction in the banking sector will have been achieved.

Second, a reinforced ESM may play a more significant role in designing and monitoring future assistance programmes. The ESM could design, negotiate and monitor the programmes in close cooperation with the Commission and the ECB. There will be no unnecessary duplication of work between the ESM and the Commission, and the cooperation will happen in full respect of the competences of the Commission laid down in the EU Treaty.

Third, the Eurogroup will continue to review the ESM toolkit. It is useful to review the effectiveness in order to modify the instruments of the ESM. The ESM has various financial tools to help euro states in crisis. However, only two of the six instruments have been used so far: loans in an ESM programme, as in the case of Greece, Ireland, Portugal and Cyprus. And loans to the Spanish government to specifically recapitalise the banking sector.

The review of the toolkit will include an examination of the precautionary tools by revising the eligibility criteria to make them more effective. In any case, the appropriate conditionality would remain the underlying principle.

The Eurogroup may also consider new ESM instruments. We have argued that a short-term stabilisation facility could be helpful to support countries which have a fundamentally healthy economy but are experiencing an economic downturn. This role could be assigned to a euro area budget, as has been proposed, or to the ESM if Member States prefer. However, the views among Member States on the need for such a facility and its design are still diverse.

Fourth, how to address debt sustainability in future adjustment programmes is also an issue. The process of deciding whether a country should engage in debt restructuring before receiving ESM support could be refined. This has nothing to do with an automatic debt restructuring. But if debt is considered unsustainable, as was the case in Greece in 2012 – which will remain an exception – we should have more transparency and clarity when handling such a situation. The ESM may facilitate the process by providing a debt sustainability analysis (DSA) and helping in the discussions. The process would need to be flexible and decisions would have to be assessed on a case-by-case basis.

These new tasks would be in line with the gradual development of the ESM since the beginning of the crisis in 2010. The ESM has built up expertise well beyond its role in the efficient financing of loans. For instance, we have set up a process to measure whether a country is able to repay our loans, including a DSA. We have also increasingly contributed to the design of programmes – primarily in the area of banking and privatisation – and financial planning.

Finally, let me say a few words about the institutional set-up of the ESM. The ESM Treaty is intergovernmental. This implies that – in legal terms – the ESM is not an EU institution.
The incorporation of the ESM into the legal framework of the European Union could take place at a later time when the EU Treaty is amended. The European Investment Bank (EIB) could serve as a model. The EIB is enshrined in the EU Treaties with its own protocol, its own capital and a Board of Directors representing its shareholders - the EU Member States. In the case of the ESM, the shareholders would be the 19 euro area countries.

Let me conclude.
Europe is united in its diversity. It is a union that consists of different cultures, different economic structures and different political traditions. Sometimes this is a challenge, but most of the time these differences complement each other. This became clear during the crisis, when all our countries worked side by side to keep the Monetary Union together. And we were successful.

As we look ahead, we need to cherish our common values and objectives. We agreed to certain common rules in the past, and we need to stick to these agreements. When we debate about where to take Europe next, we need to realise that no country will get everything it wants. National traditions and convictions will have to meet somewhere in the middle. That is how Europe functions. The ESM has well proven that this approach can work. And that it can be very successful.

Thank you.

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