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Message from the Managing Director

The European Stability Mechanism was set up to protect the euro area against the worst blows dealt by an economic crisis. Such crises happen from time to time, and have done so for hundreds of years. They can spring up suddenly, seemingly out of nowhere, for reasons that may be poorly understood at first. The problems that cause a crisis often build up for a long time – but we do not always heed the warning signals.

It was like that in the last financial crisis, a period from which the ESM was born. Several countries accumulated unsustainable misalignments during the first decade of monetary union, in the form of high debt levels, a loss of competitiveness, and growing current account deficits. In addition, the euro area was not well-equipped institutionally to deal with a serious crisis, and the monetary union threatened to break up. The rapid establishment of the ESM – and first the temporary European Financial Stability Facility (EFSF) – could not turn the clock back on the crisis. But these two institutions shielded Europe against a far worse outcome: the departure of one or more countries from the euro area.

The ESM is now a permanent feature of the monetary union and of the global financial safety net. It functions as an emergency system, which has helped to keep the euro together. Four of the five countries that were in EFSF or ESM assistance programmes are clear success stories. Greece has a chance to join this group, if it continues to implement reforms, also after the end of its programme in August. As a permanent institution, the ESM makes the monetary union more robust, and enhances the resilience of its economy. These are not abstract concepts: it means fewer job losses, and less economic damage when the next crisis hits.

But the euro area's emergency defence system is still not as solid as it could be. That is understandable: Europe had to come up with a broad policy package very quickly at the height of the crisis. Setting up the ESM was only one part of that. And while the crisis response was very successful, not all risks have gone away. Remaining deficiencies should be fixed now, in order to better prepare for the next crisis.

These steps, importantly, are relatively small in comparison to the work that has already been done. They do not represent a grand architectural design for new European institutions. I am a strong proponent of the principle of subsidiarity – taking decisions at the lowest possible level. Many things can be done better at the national or regional level. But there are a few tasks that countries simply cannot resolve on their own. Examples are control of the European Union's external borders, the fight against terrorism and dealing with climate change. These are areas where Europe needs to be strong, and where it can bring something to its citizens that countries cannot. Defending the integrity of the monetary union – and the many benefits that the single currency brings – are also areas where cooperation leads to better results than individual countries' actions.

Now is a good time to work on these remaining reforms, because the economy is thriving. The euro crisis is behind us, and Europe has come out of it stronger than before. The economy has been expanding almost twice as fast as the potential growth rate. Growth is spread evenly, with some of the former programme countries showing among the highest growth rates in the euro area. Investors – whom we meet on the frequent roadshows the ESM does across the globe – are telling us that they are seeing Europe as a safe haven for their money in today's world. This is a marked difference from a year ago, when many saw a number of elections in Europe as creating uncertainty.

Of course the risk of political disruption never goes away. Constant debate is the basis of democratic decision-making – and that debate can sometimes be prolonged and unruly. But I expect we can make real progress this year in those areas where it is most needed.

As an economist, I believe the most important issue that the euro area needs to tackle in a broad sense is that of economic risk-sharing. This is underdeveloped in the euro area, compared to the United States and to large European countries such as Germany and France. More risk-sharing means the effects of a shock are spread more easily across borders, and different cyclical developments are corrected automatically to some extent. That would make the euro area more stable, and less vulnerable. Most risk-sharing should take place through private channels – such as banks, financial markets, and cross-border capital flows – while fiscal tools can play a complementary role.

The plans to deepen monetary union that European Council President Donald Tusk laid out in December would certainly promote risk-sharing in the euro area, as would the Capital Markets Union, promoted by the European Commission, and supported by most market participants.

The first priority on the agenda is completing Banking Union. Essential steps have already been taken in the past, through the establishment of the Single Supervisory Mechanism and the Single Resolution Fund. The latter needs a financial backstop, so that it has full firepower in a big crisis. The ESM could play the role of a backstop, if that is the wish of our Members. An equally important second step to completing Banking Union is a common deposit insurance for Europe, which would reduce the risk of national bank runs during a crisis. To take that step, legacy issues need to be sorted out, something that our Members are working on. The speed at which a common deposit insurance can be implemented will depend on the progress in dealing with non-performing loans, sovereign bond exposure of banks, harmonising insolvency regimes, and the build-up of bail-inable capital.

The next point on the agenda is to develop the role of the ESM. A stronger, more powerful ESM is not a goal in itself. But our institution has built up a broad expertise and practical know-how since its inception, which makes it a natural place to house some of the new functions needed in the euro area.

Other than the backstop for the SRF, the ESM could play a greater role in future rescue programmes. Designing, negotiating, and monitoring these programmes could become a joint task of the European Commission and the ESM, without any unnecessary overlap of responsibilities, and fully respecting the role of the Commission laid down in the EU Treaty. The ESM could also play a role in a potential sovereign debt restructuring framework, designed to make settlements with private creditors more predictable and more transparent, without introducing any rigid or automatic rules. Finally, I support the integration of the ESM into the EU Treaty. This should not, however, happen through secondary law, but instead at the moment that the EU Treaty, one day, is changed. The model of the European Investment Bank seems to be an appropriate one for the ESM, with its own protocol in the EU Treaty, its own capital, and a board with representatives from member states. Until then, the ESM can continue successfully as an intergovernmental institution.

Fiscal matters are the third and final point on the agenda to deepen monetary union. But these are particularly controversial. There are a wide range of ideas, such as a euro area budget for investments, a revolving fund to tackle asymmetric shocks, and a euro area finance minister. The debate on these fiscal issues needs to progress.

In my view, a monetary union should have a certain fiscal capacity to broaden the fiscal space at the national level. That can be done without adding to fiscal transfers – which are traditionally provided via the EU budget to promote real convergence – and without debt mutualisation. Several tools are imaginable for such a fiscal capacity, and some of them have been successfully used in the United States for a long time. Examples are a rainy day fund, or a complementary unemployment insurance. A new ESM facility, with shorter maturities and less conditionality than a full-scale ESM programme, could be useful in this context, and would be relatively easy to implement – at least in a technical sense.

With these new measures, Europe would be better prepared when the next crisis hits. That is also in the interest of the ESM, because it would protect our outstanding claims. The more such measures are implemented, the more resilient the euro area becomes, and the less vulnerable. That means there would be less need for traditional ESM adjustment programmes – and that would be very welcome.