European Stability Mechanism

Klaus Regling, ESM Managing Director
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(*Please check against delivery*)

Ladies and gentlemen,

Before discussing the future of EMU, I would like to make two preliminary remarks. First, the euro is good for Europe, and also for Germany. The real economic advantages of the euro are clear: cross-border trade between euro area countries has been boosted, and transaction costs have fallen sharply. Price transparency has increased, leading to greater competition and thus to better and cheaper products. More competition in the euro area will also lead to higher productivity and thus to more growth.

The fact that the euro has put an end to intra-European currency turmoil is another major advantage. Foreign exchange upheaval was frequent in Europe from the end of the Bretton Woods system in the early 1970s to the start of EMU. In 1995, for example, the Tequila crisis triggered a massive appreciation of the Deutschmark against other European currencies. German exports suffered, which cost the country one percentage point of growth that year.

It is also important to recognise that Europe risks losing relevance on the global stage, unless it joins forces. Today, Europe is a strong player next to blocs such as the U.S., Japan, and China. But while Europe made up 32% of the world economy in 1970, that share now stands at 23%. By 2050, it is projected to be just 9%. The weight of individual European countries, even large ones like Germany, would only be a fraction of that.

My second preliminary remark is about the significant progress monetary union has made over the past few years. Europe has come out of the euro crisis stronger than before, both economically and in terms of its institutional architecture.

In the first place, this is because countries that lost market access did their homework. Budget deficits have decreased significantly everywhere, and competitiveness has been regained through cuts in nominal wages and salaries. Policy coordination at the European level has also been broadened and strengthened.

We have also seen important institutional developments the last few years. The ESM was established in 2012. It filled an important gap in the institutional framework of EMU as a lender of last resort to sovereigns, a function that did not exist before the crisis. We have assisted five euro area countries, providing €265 billion in loans. Money is disbursed only under the strict condition that countries implement comprehensive economic reform. This considerable financial solidarity comes at no cost to the taxpayer (though our shareholders do of course take on the risk associated with the programmes). Another innovation is Banking Union, which saw the establishment of the Single Supervisory Mechanism and the Single Resolution Mechanism.

In summary, Europe has deployed an effective strategy to move out of the crisis. The sustained economic recovery confirms this, even if problems such as high unemployment persist in some countries.

What else is needed to make the euro more robust, and to render the euro area economy more resilient? A first obvious point is that member states should apply the fiscal rules they have imposed upon themselves. Secondly, countries need to continue to implement structural reforms to raise potential growth and should implement country-specific recommendations more consistently. These two points are true for all euro area countries, not just for current or former ESM programme countries, who have already proven to be reform champions, according to the OECD and the World Bank.

Any new steps needed to complete EMU are modest compared to the progress we have already made. In my view, Monetary Union does not need a full Fiscal Union to function properly, nor a full Political Union. But certain additional measures would be useful.

First we need to complete Banking Union, which would strengthen financial integration and risk-sharing via markets. Banking Union lacks a common backstop for the Single Resolution Fund. Setting up such a backstop would make the SRF more credible.

The other important step to complete Banking Union would be some form of European deposit insurance. Obviously, before this can happen, any legacy problems at banks need to be addressed. We need to de-risk first, because no country with a healthy banking system should have to pay for past mistakes by its neighbours. Consequently, it will take a while before a European deposit insurance exists. But the advantages would be considerable. By putting a credible common deposit insurance in place, the risk of a nation-wide bank run disappears. When a member state of EMU is under attack from markets people would be reassured that it is not just their own government backing their money, but the entire euro area. The reason for a bank run would disappear. So putting such a deposit insurance in place is the best way to ensure it will not be needed.

Capital Markets Union would also strengthen financial integration and make the euro area more robust. By harmonising corporate, tax and insolvency laws, European countries would lower barriers for equity flows and other investments across borders. This would facilitate equity investments from one country into another and help reduce Europe’s excessive reliance on bank funding.

Another step that would make EMU more robust would be a limited fiscal capacity to tackle asymmetric shocks. I know the fear that this could lead to debt mutualisation and permanent budget transfers. But examples in the US show this need not be the case. US states can for instance draw on a rainy day fund or supplementary unemployment schemes to help them through tough times, and have to refund the money later.

Let me finally say a word about a European Monetary Fund, an issue that is currently being discussed by many politicians, central bankers and academics. First let me stress that I fully assume that the IMF will be part of solving the last remaining case of the previous crisis: Greece. But there seems to be a growing consensus in Europe that the Fund will not play the same role in a next euro area crisis. The ESM could then play a bigger role.

Since its inception, the ESM has developed significantly. Nowadays, we no longer just finance assistance programmes. The ESM participates in missions to programme countries, we analyse debt sustainability, and we monitor countries' repayment capacity through our early warning system. Moreover, former ECB board member Gertrude Tumpel-Gugerell is currently leading an independent evaluation of past ESM programmes. She will present the results to euro area finance ministers in June, and will formulate independent recommendations on how the ESM can improve its work.

Of course, it is conceivable that the ESM will develop into an institution that is even more similar to the IMF than it is now. This would require at the least a change of the ESM treaty – if not a change of the EU treaty – and would therefore require a consensus among our Member States.

Let me finish here. The single currency is bringing many economic benefits. The euro area did well to defend it during the crisis. We need to perfect monetary union, but what remains to be done is modest. The broad support the euro enjoys among euro area citizens gives policymakers the mandate to take the steps that I have just laid out to make monetary union more robust.