

Policy measures to support the EU economies - speech by Klaus Regling

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05/09/2020

Speeches

ESM

Cernobbio, Italy



Klaus Regling, ESM Managing Director **“Policy measures to support the EU economies”** **Ambrosetti Forum** **Cernobbio, 5 September 2020**

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Good morning,

I was very pleased to accept the invitation to speak at this important Forum. We are experiencing by far the most challenging crisis we have had in many years. The magnitude of the damage is unlike anything we have seen in our lifetime. All forecasts show that Europe will register this year the deepest recession in a century. It will take at least two more years for economic activity to reach pre-crisis levels.

The images of lockdowns, here in Italy and elsewhere, and the memory of those who

suffered the most during the pandemic outbreak will last long. But we must find a way forward with hope and determination.

The situation is bad for all European countries. In that sense, we are dealing with a symmetric shock. However, we know that some countries have been more affected by the crisis than others, and that risks deepening divergences and undermining the functioning of the Single Market and of our monetary union.

I. Convincing reaction from European governments and institutions

Europe reacted swiftly to address the economic consequences of Covid-19 with a strong and concerted response precisely designed to help the most affected countries.

A first package, amounting to €540 billion, was already agreed in May. It comprises three safety nets - one for sovereigns provided by the ESM, one for businesses provided by the European Investment Bank and one for workers provided by the EU Commission. Money from these three safety nets is available now or very soon.

A second package was agreed in July, the €750 billion “Next Generation EU” package that will boost the next EU budget. Money from this package will start flowing in 2021.

I have no doubt that these measures at the European level - which come on top of significant national measures in every EU member state - will greatly help to limit the economic, financial and social damage of Covid-19 and to maintain a level-playing field.

The world is also impressed by the speed of the European action, the volume of the different measures, the unprecedented degree of solidarity and the efficient cooperation between national governments and European institutions, including the ECB. In my frequent contacts with financial markets, I hear this again and again. The view on Europe and in particular on EMU has never been as positive during the last decade as it is today.

So, my conclusion up to now is clear: Europe has reacted in a convincing way to the unprecedented crisis caused by Covid-19. Governments and institutions have done

the right thing!

II. Challenges for the future

Nevertheless, the agenda ahead of us is challenging - even after the immediate effects of Covid-19 are overcome - and will require determination and strong actions from governments and institutions.

I am worried about four issues that, unfortunately, are all likely to have a negative impact on future growth in all EU economies:

1. The potential growth rate after Covid-19 is likely to be lower than before the crisis. The pandemic is destroying capital, including human capital, it leaves investors reluctant to invest, given the high degree of uncertainty, and has led to much higher household savings.
2. The collapse in world trade, which means less competition and therefore less productivity gains. This comes on top of de-globalisation that began before the pandemic and will also depress potential growth.
3. The banking system. It is a vital element in the recovery phase after the pandemic. But banks, although safer than in the past financial crisis, are still emerging from a long healing process, struggling with persistent low profitability, over-banking in some countries and high levels of non-performing loans in others, and may not have the capacity to provide sufficient credit for investment.
4. Finally, higher public deficits and debt are absolutely necessary now in response to the crisis. However, not all debt is productive. As former European Central Bank President Mario Draghi reminded us last month in Rimini, there is “good” debt, if invested in human capital and crucial infrastructure for production and research, and then there is “bad” debt, which is used for unproductive purposes. It will not be easy to reduce fiscal deficits over the next few years to sustainable levels.

Given these headwinds, it is important that EU's strategy for the next decade focuses on enhancing competitiveness and productivity, while supporting the green and digital transition. We need to make sure that the policies we put in place today support a sustainable, stronger and a greener growth for the future.

III. Deepening EMU remains important

The challenges for all EU economies and its citizens will be huge. But we should not forget the agenda for deepening EMU further.

The measures taken so far in response to Covid-19, which will benefit all EU member states, are also very much welcome from the perspective of our monetary union as they are designed to prevent economic divergences among euro area countries and can also contribute to a stronger international role of the euro.

The euro area is where Europe has integrated most economically and financially, and is therefore the focus of global investors. For the euro area, we have a clear agenda for the future through the deepening of Economic Monetary Union: completing the ESM reform, completing banking union, creating a capital markets union, setting-up a fiscal capacity for macroeconomic stabilisation and increasing the volume of safe euro assets.

One important element of the ESM reform is the backstop to the Single Resolution Fund (SRF). The backstop to the SRF - together with some form of common deposit insurance - would complete banking union. Further integration of the banking market will lead to more cross-border risk-sharing through the private sector. Cross-border consolidation could help the profitability of some banks.

Progress on capital markets union would facilitate cross-border equity investments and provide new ways of financing businesses. All this would improve the allocation of capital in EMU, enhancing growth potential and making the euro more attractive to international investors.

I believe that a permanent fiscal stabilisation mechanism for euro area countries, which would be different from the agreed "Next Generation EU" budget, will be needed eventually, for the euro area.

Such a facility would not have to be an annual budget - there will be many years when it is not needed - but a revolving fund, to be repaid within a cycle. With the revolving fund replenished, money could be used again in the next crises for another country.

Such a fiscal capacity is needed because countries that are members of EMU have

given up two key macroeconomic policy instruments: monetary policy and exchange rate policy. Therefore, they can only rely on fiscal policy to react in a crisis.

The ESM, which has diversified its instruments with the recently created Pandemic Crisis Support, could add such a shorter-term facility to its range of instruments. This would help countries bolster their national fiscal buffers and give them more fiscal space in a crisis.

Finally, the important role of a European safe asset is being recognised more and more. A safe asset would facilitate the transmission of monetary policy throughout EMU, allow Europe's banks to reduce their holdings of national sovereign debt, and strengthen the international role of the euro.

The measures taken in response to Covid-19 can increase the amount of European debt issued by the Commission, the EIB and the ESM from €800 billion today to almost €2 trillion. Together with sovereign debt issued by highly-rated euro area countries, the amount of safe assets in the euro area would increase to 40% of euro area GDP over the coming years, much better than the 25% at the end of last year, but still below the 90% of the United States.

So, we have taken important steps and we continue to move in the right direction, but a lot remains to be done.

As Robert Schuman said in his famous speech on 9 May 1950: "Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements, which first create a de facto solidarity." This captures well the challenges we face today.

I believe we are going through another defining moment in European integration. We need to give convincing answers, to help European citizens and economies to recover and to protect European sovereignty in an uncertain world.

I am looking forward with great interest to our debate today.

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