Time to Take Europe’s Economy Seriously

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Ladies and gentlemen,

Many thanks for inviting me to the Economist summit on Cyprus. It is by now a tradition for me to be here. And it is a great pleasure to see the economic progress Cyprus has made over the last 12 months. I am very pleased with the title of this session with Minister Georgiades: “Time to take Europe’s economy seriously.” I couldn’t agree more. I will use the next 10 minutes to tell you why.

There is a pessimistic view on Europe that is both widespread - and misguided. It is the mistaken view that Europe is stumbling from crisis to crisis, without learning. It is the mistaken view that Europe is an unfinished project, and that it malfunctions.

The truth is, that all in all, Europe’s economy is in reasonably good shape. The crisis has made it stronger. Large majorities of the people support the euro, its most visible achievement.

Economic growth in the EU is above potential. Per-capita growth is at the same level again as in the US, just like it was for decades until 2009. There are also a number of important political and economic advantages when compared to the US, such as greater income equality and a rising participation rate.

In response to the euro crisis, Europe has taken a number of important steps to improve its policy framework and institutional architecture. Crucially, countries that had lost market access, did their homework. They put their fiscal house in order and adjusted macroeconomic policies. This speaks to the credit of governments and citizens – including those in Cyprus of course. At the European level, the Commission has been given greater powers to monitor countries and discipline them when they break the rules. And there is now a procedure to monitor macroeconomic imbalances.

The ECB played a crucial role in fighting the sovereign debt crisis, through its unorthodox policy measures. In the area of prudential oversight, important competences have been transferred to the European level by setting up the SSM and the SRB. Such progress would have been unthinkable only a few years ago.

The two institutions that I manage – the ESM and its predecessor the EFSF – are the lender of last resort for sovereigns in the euro area, a function that did not exist before the crisis. We have a total of €246 billion in loans outstanding, three times as much as the IMF globally. We've assisted five countries during the crisis: Greece, Ireland, Portugal, Spain and Cyprus. Four of these are now success stories. I expect that Greece can also begin to return to markets next year, if it continues to reform.

To summarize, the crisis has caused European integration to speed up considerably. Six years ago, many people said the single currency would fall apart. But it didn't. Europe came out of the crisis stronger than it was before. Someone who says that Europe has achieved little is blind to the facts, or – for whatever reason – biased.

I won't deny that Europe is also facing challenges. Brexit is one. And Europe's potential growth rate is too low. More investment and structural reforms are needed to raise it. Also, European banks are still behind their US rivals in terms of profitability and leverage ratios. Consequently, the sector remains more fragmented than before the crisis.

These challenges will require much work over the coming years. But I do not believe that new big steps are needed in order for the Economic and Monetary Union to properly function. The fact that 19 sovereign nations in the euro area took joint action so quickly proves that we do not need a full political union. The fact that the economy is doing well - and that former programme countries such as Ireland and Spain are now Europe’s growth champions - shows that we do not need a full fiscal union. The euro area works well, and there is no need for a full political union nor a full fiscal union.

The one problem the EMU still faces is the low degree with which asymmetric economic shocks are shared between countries. Risk sharing is lagging well behind the 50 states in the US, but also behind larger member economies such as France or Germany. This is true for the three different channels through which risk sharing occurs: fiscal mechanisms, credit markets and capital markets. This may sound like an academic point. But it leads me to make a few recommendations for some tangible measures.

First, Banking Union should be completed. I already mentioned the first two pillars – SSM and SRF. We also need a financial backstop for the Single Resolution Fund to make it more credible for markets. Eventually, a European Deposit Insurance Scheme, or EDIS is needed. This will not be easy because existing national schemes are very different and because some countries must sort out legacy problems first. So, it will take time to establish EDIS but several models exist for how this could be done.

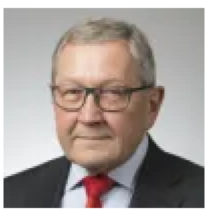
Secondly, banks need to aggressively reduce non-performing loans. Bank regulators and their political counterparts need to commit to tackling this problem. And banks in Europe need to improve profitability. This means cutting costs, reducing the number of branches, and fully using fintech solutions. But most of all it means sector consolidation, including across borders.

Thirdly, we should move towards a Capital Markets Union. This ambitious project entails harmonizing corporate, bankruptcy and tax law across Europe. It would be a big support for private equity investment and would - at the same time - open up an alternative channel of funding for companies. It is encouraging to see that the Commission recently accelerated part of the time table.

In addition to these steps – which would all enhance risk sharing through capital markets - a limited fiscal capacity for the euro zone could further help. This could be done without permanent transfers or debt mutualisation.

Let me summarize. The prevailing pessimist view on Europe is certainly exaggerated. The truth is, on the whole, Europe is doing reasonably well. It has made tremendous progress since the crisis. Challenges remain – as always. But we can tackle them with relatively small steps, in comparison to the huge leaps Europe has taken in the last 6 years.

Author



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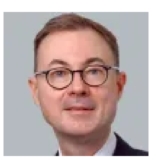

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