"Germany, Greece, and the euro" - speech by Klaus Regling at Documenta Kassel

View PDF
09/09/2017
Speeches
Kassel, Germany

Klaus Regling, ESM Managing Director
Documenta 14 lecture
"Germany, Greece, and the euro"
Kassel, 9 September 2017

(*Please check against delivery*)

Ladies and gentlemen,

Let me first express my heartfelt thanks to the *Friends of Documenta*/Kassel, the Europa-Union, and the Sparkasse, who invited me to speak here. As the Managing Director of the European Stability Mechanism – known more commonly as the euro crisis fund – I'm invited to speak at many events. But this is the first time I'll be doing so at an art exhibition. So it is a special honour for me that this debut should take place at the Documenta, one of the most important exhibition series of contemporary art in the world.

With Documenta 14, separate exhibitions are being held in two different places for the first time: in Athens until the end of July, and here in Kassel until the middle of September. When I was in Athens in July, I could see the striking image of the Greek

owl on the Documenta posters. I regretted my full schedule did not allow me to see the exhibition. This time, I can assure you I won’t miss it.

It is easy to see similarities with the ESM in the close partnership that Documenta 14 has with Greece. As Greece’s largest creditor by far, the ESM is also in a close partnership with the country. Greece’s success is of vital interest to our organisation. In other words, Greece should completely overcome the crisis, with the help of our assistance loans, and through a strict implementation of the necessary economic reforms. That way a competitive economy will emerge, one that will create jobs and greater wealth for its citizens.

I like Documenta curator Adam Szymczyk’s idea of organising exhibitions both in Kassel and in Athens. Greece’s tremendous problems during the euro crisis have caused regrettable tensions amongst the euro area countries, and between the German and Greek people. At the height of the crisis, this has sometimes caused nasty conflicts. At times, there was talk of Greece leaving the monetary union. The joint exhibitions were a contribution to reducing these tensions. The Documenta exhibitions attracted large crowds in both places. Direct flights between Kassel and Athens were even set up during the twin events.

German President Frank-Walter Steinmeier and Greek President Prokopis Pavlopoulos built bridges, when the two heads of state jointly opened the exhibitions in Athens in April, and in Kassel in July. Here in Kassel, the German President said: „Let me be very clear. For us Germans, Greece belongs to the same European house as we do.“ I completely agree with his words.

The title of my speech is „Germany, Greece and the euro“, and I will address three different topics.

- First, I will explain why the creation of the euro and the ESM were in Germany’s own best interest from an economic, political, and strategic point of view. And the same holds true for the other 18 euro area member states, of course.

- I will then show that the ESM’s rescue strategy is a success, and why I am also optimistic about Greece, despite all its difficulties. I will take issue with our critics, who say that Greece is the victim of a „neocolonial“ attitude and scarred by a „humiliating crisis stigma“. Documenta curator Szymczyk is also of this

opinion, or so I read in the newspapers.
- I will end my remarks by mentioning a number of concrete and limited steps to make the euro and monetary union more robust.

The euro has often been a controversial topic in Germany. This was the case before its introduction, when many academics and commentators warned about [the dangers of] the single currency, saying that Germany would be better off with the Deutschmark. And it was also the case at the height of the euro crisis. Academics and commentators predicted the end of monetary union, and repeated that Germany would be in a better position without the euro.

By now, such opinions are less prominent. Even our doubters can see that we have found answers to the euro crisis, and that the crisis is behind us. People on this continent and elsewhere in the world are now seeing Europe and the monetary union as an economic and political safe haven. That has to do with Brexit, the election of Donald Trump as the U.S. President, and with the pro-European outcome of elections in France, the Netherlands, Austria and – in all likelihood – also in Germany in two weeks‘ time. And this is reflected in the popularity of the euro. The latest polls show that some 80% of the German population supports the single currency.

For me as an economist, the advantages of the monetary union are obvious. The euro boosted cross-border trade among euro area countries, and transaction costs have clearly fallen, by an estimated €20 to €25 billion per year. That means price transparency has risen, which in turn led to more competition. Economists know that more competition leads to higher productivity, and therefore to more growth. Hardly any country could benefit more from the euro than Germany, because of its central position in the heart of Europe and its export-oriented economy. In one sentence: if the euro area is doing well, so is Germany.

What is often forgotten is that the introduction of the euro put an end to currency turmoil between European countries. But such turmoil occurred quite frequently in the period between the early 1970s until the introduction of the euro. In 1991 and 1992 for instance, the Bundesbank executed interventions of around 100 billion Deutschmark to keep the French franc inside the European currency system. In 1995, the so-called Tequila crisis – problems in Mexico in other words – led to a massive appreciation of the Deutschmark in comparison to other European currencies. German exports clearly suffered. The appreciation cost the German

economy one percentage point of growth at the time.

Try to imagine the economic turmoil – and probably political turmoil too – that the individual countries of the euro area would have gone through if we had not had the euro during the many crises of the last 20 years, but would have instead had the Deutschmark, the franc, the lira, the peseta, the schilling, the escudo and a dozen other currencies. Because crises there were plenty: the Asia crisis, the Russia crisis, the bursting of the dotcom bubble, the global financial crisis, and the Lehman bankruptcy. Without the euro, all these events would very probably have led to large currency fluctuations in Europe, just as we saw in the 1980s and 1990s.

The euro has given Europe the relevance and clout on the global stage that its individual members simply would no longer have. The euro is the second-most important reserve currency of the world. Europe is a strong actor and can see eye-to-eye with other large currency and economic regions: the U.S.A, Japan, and China. Let’s not forget that Europe’s economic relevance is steadily decreasing. In 1970, Europe made up 32% of the global economy. Nowadays, the number stands at 23% and it is estimated that it will drop to 9% by 2050. Individual member states would hardly count any more, even big European economies like Germany.

For these reasons, the common currency is an achievement that all euro area countries should defend. Early in 2010, the monetary union was facing a situation the founders of the euro could not have imagined: a loss of market access by euro area countries. This brought to light a gap in the institutional architecture of the euro area. There was no instrument, no mechanism, and no institution that could help in such a case and offer a sustainable remedy.

Given this situation, first the EFSF was established in 2010 as a temporary solution and then the ESM as a permanent institution in 2012. Both are mandated to provide rescue loans in return for economic reforms in case of a temporary loss of market access.

I don’t believe there were credible alternatives at the time. Had these rescue mechanisms not been set up at the height of the crisis, the consequences for monetary union would have been dramatic. Countries such as Greece, Ireland, and Portugal would probably have left the euro in chaos, and the resulting social and political consequences would have been hard to predict. It could also have been

dangerous for other economies because of probable contagion effects. And that would have put the euro itself in danger. It is therefore a good thing that we prevented a break-up of the monetary union. Economically and politically, Europe would look very differently if we had failed to do so.

Let me now say something about the rescue strategy of the ESM. So far, the ESM and its temporary predecessor the European Financial Stability Facility or EFSF, have paid out €272 billion in emergency loans to five countries: Greece, Ireland, Portugal, Spain, and Cyprus. When I say emergency loans, this of course means that programme countries need to fully repay those loans with interest. We don't give away money.

But it is true that with these loans our Members do take on risk. That is why the German finance minister needs a mandate of the German parliament for the disbursement of each tranche of an ESM loan. This transfer of risk is an act of solidarity among euro area countries. But it does not make the monetary union into a transfer union.

Despite this, the accusation that we break the rules is levelled at us time and time again, especially in Germany. And that while both the German Federal Constitutional Court and the European Court of Justice have confirmed the legality of the EFSF and ESM rescue mechanisms on multiple occasions at the highest legal level. Since 2011, the Federal Constitutional Court has issued five injunctions that relate to us. In these rulings, the Federal Constitutional Court has strengthened the role of the German lower house and its members and has explicitly said that setting up the EFSF and the ESM and the duties that flow from it are in line with the law.

The European Court of Justice in its ruling of 27 November 2012 clearly notes that the granting of financial assistance by the ESM does not violate the no bail-out clause because programme countries remain responsible for their liabilities with creditors.

When granting credits, we are following the same principle that has proven its value over decades at the IMF: money only flows once a programme country's government has successfully implemented the required economic reforms that were agreed at the beginning of the programme. The reform menu ordinarily features budget consolidation, structural reforms, and financial sector repairs.

Ireland, Portugal, Spain and Cyprus successfully ended our reform programmes within the agreed time frame, normally three years. Our loans gave these countries the time and the fiscal room to manoeuvre that they needed to make their economies competitive again and to solve problems in the financial sector. All our former programme countries are real champions in implementing economic reforms, studies by international organisations like the World Bank show.

Such efforts are paying off now for the countries and their citizens: Ireland and Spain, for instance, have the highest growth rates in the euro area, and the numbers in Portugal and Cyprus are also good. Unemployment in these countries is clearly on the way down. The former programme countries contribute to the fact that the euro area now is solid and dynamic again, and does not need to shy away from comparisons with other large currency regions.

Greece is a special case among the five programme countries. Nowhere else were the problems so serious, and nowhere else was the government's ability to act so weak. On top of that, the country marched in the wrong direction under Finance Minister Varoufakis for a period of six months in 2015. Those are the reasons why, even now in the seventh programme year, our stability efforts have not yet been completed.

In the current ESM programme, we have disbursed around €39 billion to Greece since August 2015 out of a total programme of up to €86 billion. From the beginning of the first programme in 2010, the total now stands at €181 billion euro. The ESM programmes runs until August 2018, but I do not expect that the country will need the total remaining funds of around €46 billion in that period. And that means we'll probably stay clearly below the programme maximum.

Particularly in Germany, I hear over and over again that nothing has happened in Greece in the past years. This is an unacceptable distortion of the facts, and an insult to the Greek people, who have had to accept cuts in wages, salaries, and pensions that would have been unimaginable in Germany.

So let me stress that Greece has made considerable progress. The budget trajectory is particularly noteworthy. In 2009, the budget deficit was more than 15% of Gross Domestic Product (GDP). In 2016, Greece had achieved a budget surplus of 0.7 percent. Only Germany and three other EU countries had a surplus that was

somewhat higher. Such a consolidation success would have been impossible without fundamental reforms. Germany should value and respect that.
Reforms in the public administration – which now employs a quarter fewer staff – in the pension system, the labour market, and the banking sector were among the most important structural reforms in Greece during the EFSF and ESM programmes.

Allow me to say a few words about the criticism that Greece has fallen victim to a „neocolonial“ attitude of its creditors through the economic reforms. This view is superficial, and wrong, and I strongly reject it. Yes, the necessary reforms had a high social cost. They caused substantial losses for many people in Greece, and a lot of pain. But the question is what alternatives were there for a country that investors no longer wanted to lend money to.

Greece had very high reform needs in 2008. At the start of the crisis, it became clear that Greek average income had risen by too much in the decade before the crisis. It had almost doubled. That was the highest increase of all euro area countries, and wasn’t supported by a comparable increase in productivity. And so, Greece lost competitiveness. The budget and current account deficits became unsustainable and needed to be corrected.

The ESM emergency loans have helped a great deal to do so. We provide them at extremely low rates, and maturities of several decades. The Greek budget saved almost €10 billion in 2016 alone because of these favourable lending conditions. And similar savings are repeated year after year. Our rescue strategy isn’t „colonial“. On the contrary, it is an expression of solidarity between euro area countries. Our long maturities allow Greece to spread the painful reform process over time and to make the pain more bearable for the people who are affected by it.

The only alternative for our rescue loans would have been a risky cure-or-kill remedy for Greece, a brutal almost overnight adaptation process. The country would no longer have been able to finance vital services such as hospitals or the police. It would have been intolerable for the people, and risked Greece’s political stability.

The Greek government is now on the right track to successfully end the ESM programme, as long as it continues to implement the agreed reforms. Under that condition, the government should be able to regularly refinance itself in the financial market. In July, the government was able to issue a first government bond. It is a

sign that investors have started to trust Greece again. If the government sticks to its reform course, the other euro area countries could provide further debt relief after it ends the current programme in 2018 – obviously only if there is the need to do so.

Finally, I would like to talk about what needs to be done to make monetary union more robust with a number of targeted steps. I say “more” robust, because an enormous amount of work has already been done since 2010, and the remaining steps are small.

Europe has come out of the crisis stronger than before, both economically and institutionally. There are many reasons for that. First, the five countries that received assistance from the EFSF and the ESM did their homework. Budget deficits have clearly decreased everywhere. Competition has been restored through lowering nominal wages and salaries – what we call internal devaluations – and through structural reforms, particularly in programme countries. Furthermore, coordination of economic policy at the European level has been strengthened and deepened. There have also been important institutional innovations in the past years. As a lender of last resort for euro area countries, the ESM fills an institutional gap, as this function did not exist before the crisis. A further institutional innovation is Banking Union, which has led to the creation of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). In short: Europe overcame the crisis by developing an efficient strategy.

The economic recovery that started in 2015, which has become stronger recently, confirms this. Euro area growth came in above that in the U.S. in 2016. Of course we should not forget that we still have some problems, such as high unemployment in some euro area countries, particularly among young people.

What else should we do to make the monetary union even more resilient? There are a number of obvious points.

In the first place, the countries of the euro area should abide, with determination, by the rules that they have already agreed. These rules need to be simplified, in particular the monitoring of budgetary policies. Over time, the rules have become so complex, that even experts like myself sometimes struggle to understand them. This weakens the credibility and legitimacy of the rules.

In the second place, countries should continue to implement structural reforms to increase potential growth, by implementing the recommendations of the European Commission more consistently. That is true for all members of the monetary union, not just for ESM programme countries.

The additional steps that are needed to complete the monetary union, are modest in comparison to the measures we have already taken. To be very clear: we do not need a full fiscal union with additional transfers, nor a full political union, for the proper functioning of monetary union. I am also a proponent of a strict adherence to the subsidiarity principle. If certain things can be done better at the national or local level, we should leave them there, closer to the people, and not transfer them to the European level – in the monetary union, nor in the European Union.

But certain further steps could be useful. In the first place, we should complete Banking Union. This would strengthen financial integration in the monetary union and risk sharing through financial markets. What is lacking in Banking Union is a common backstop for the single resolution fund, the SRF. Creating such a backstop would strengthen the credibility of the SRF.

The other important step to completing Banking Union would be a form of European deposit insurance. This would first require clearing out the problems with legacy assets that still exist with some banks in the euro area. Such risks must be reduced, because no country with a healthy banking system should pay for the past mistakes of banks and supervisors in other euro area countries. And this means it will take a while before a European deposit insurance will see the light of day. And as I am speaking at a savings bank, I would like to add that I am aware of the scepticism among saving banks about this issue of a common deposit insurance.

But the advantages of such a credible common deposit insurance are considerable, as it would take away the risk of a bank run on the entire banking system in a country. If a country is under pressure from the market, depositors would know that it is not just their own country backing their deposits, but the entire euro area. And this means that the reason for a country-wide bank run, which would certainly pose a risk for financial stability across borders, disappears. Creating a European deposit insurance that is credible is the best guarantee it won't be needed.

Capital Markets Union would further strengthen financial integration and make the

euro area more robust. Harmonising corporate, tax, and bankruptcy law across Europe would lower the hurdles that are standing in the way of cross-border investments. This would ease cross-border shareholdings and reduce European companies' overreliance on bank loans to finance investments.

A limited fiscal capacity to counter so-called asymmetrical shocks would be a further step towards a more resilient monetary union. I know the fear that this would lead to debt mutualisation and permanent budget transfers. But examples from the U.S.A. show that a limited fiscal capacity is possible without debt mutualisation and permanent budget transfers. They have so-called rainy day funds and a complementary unemployment insurance. The individual states fund their rainy day funds in advance. A rainy day fund for the euro area would have to be 1% to 2% of the economy, so €100 or €200 billion. The complementary unemployment insurance would be financed from a small fraction of existing employer and employee payments. So there is no extra financing needed.

A permanent president of the Eurogroup could also be useful, to better represent the euro area in international bodies such as the G7 or the IMF. Whether that person should be called a European finance minister, or whether he or she should get additional tasks is something for the euro area countries to sort.

What we don't need in the euro area is a large investment budget. Such an instrument already exists for the EU in the form of the so-called Juncker Plan and the general subsidies that are available through the European Investment Bank. If needed, such means can be increased. In my opinion, we also do not need more permanent transfers to promote real convergence in the EU. The EU budget rightly has been financing transfers from rich to poor EU countries for the past 60 years. These can amount to 4% of the GDP of the receiving countries, which is substantial.

We also do not need a large additional budget to counter deep symmetric crises. We have shown that in truly exceptional cases, we can successfully fight a crisis through a targeted increase in budget expenditures, such as during the global financial crisis of 2008/09. An exception clause in the Stability and Growth Pact allows breaching the three percent deficit maximum in case of a severe crisis.

Finally, let me say a few words about a European Monetary Fund. A consensus is growing inside Europe that the IMF will not play the same role as it has done if a

next crisis breaks out in the euro area. The ESM could in that case play a larger role.

Indeed, the ESM has clearly developed since it was set up. Nowadays, it no longer just finances rescue loans. It also participates in monitoring missions in programme countries, it analyses debt sustainability, and it ensures the ability of former programme countries to pay back their ESM loans through its Early Warning System.

At the moment, a range of proposals exist to transform the ESM into a European Monetary Fund. It is easily imaginable that the ESM will develop into an institution that looks even more like the IMF than is the case presently. But it is equally certain that this would require a change of the ESM Treaty at least – if not the EU Treaty – which requires consensus among all our Member States.

One thing is clear. These targeted and limited improvements would be in everybody’s interest. To state it clearly again: these further steps have been conceived in such a way that they will not lead to permanent transfers or debt mutualisation in the euro area. Even in the short term, no country would be burdened excessively. And in the long run, every country would refund any support that it received on a temporary basis. Every euro area country benefits from a monetary union that is waterproof. That is as true for Germany as it is for Greece.

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

George Matlock
Senior Financial Spokesperson
+352 260 962 232
g.matlock@esm.europa.eu