“Budgetary Aspects for Stabilising EMU” - speech by Klaus Regling

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Klaus Regling, ESM Managing Director
“Budgetary Aspects for Stabilising EMU”
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(*please check against delivery*)

Ladies and gentlemen,

Thank you very much for inviting me today. I’m always happy to exchange views with the European Parliament. Today’s workshop focuses on the budgetary aspects of deepening monetary union. This is an important – and controversial - topic. But before I begin, let me point out that I am a regular visitor to this Parliament, even if no formal ties with the ESM exist. My institution is accountable to the euro area countries, whose financial contributions enable us to do our job. On their part, the 19 euro area finance ministers, who are also the Board of Governors of the ESM, are accountable to their national parliaments. Still, I am always available to answer your questions and to explain our work. Particularly now that we are working towards the common goal of making the monetary union more robust and the euro area economy more resilient.

The December package of the European Commission provided strong momentum for this drive to deepen monetary union. Its goal is to fix important weaknesses in the set-up of the Monetary Union, something I very much welcome. Concrete work has now started on the two topics about which there is most consensus: the completion of Banking Union and the development of the ESM.

Budgetary instruments are another part of the discussions. But one cannot look at them in isolation. The completion of the Banking Union and the use of new fiscal tools serve the same economic objective: to increase economic risk-sharing. There is even a trade-off between these two. The more risk is shared through the private sector, the less need there is for fiscal tools to share risk. I will return to this point in a moment. A second reason why we should look at the package in its entirety is that the views on fiscal measures are still diverging, and that it will take more time to reach an agreement. So before I turn to budgetary aspects, let me briefly mention those two areas of the work to deepen monetary union where we have seen more convergence.

As far as the Banking Union is concerned, Europe has already put in place its first two pillars: the Single Supervisory Mechanism and the Single Resolution Fund. To complete the Banking Union, the SRF needs a financial backstop, which will likely be a new role for the ESM. A common deposit insurance is another crucial step, because it would promote financial integration and confidence among depositors, and because it would prevent national bank runs during a next crisis. But this is politically more controversial as a number of legacy problems exist, which need to be dealt with.

On the development of my own institution, let me say the following. When I listen to discussions in the Eurogroup, I sense broad support among euro area countries to transform the ESM into a more fully developed crisis resolution mechanism. A more powerful ESM is not a goal in itself. But – like completing the banking union – it can be an element to make the monetary union less vulnerable, and would show that Europe is taking on more responsibility to solve its own problems.

Other than a backstop to the SRF, the ESM is likely to also play a larger role in any future financial assistance programmes. Together with the Commission, it would jointly be responsible for designing, negotiating and monitoring new programmes. Of course, this cooperation will be with full respect to the Commission’s competences, and without unnecessary overlap of duties.

The ESM could also play a role as a facilitator of negotiations of future sovereign debt restructurings, to make such talks more orderly and predictable. It could also house a new fiscal facility for macroeconomic stabilisation or investment protection. This takes me to today’s main topic: the budgetary aspects of deepening monetary union. To better understand how I see this issue, I’d like to discuss economic risk sharing in more detail. Economic risk sharing is underdeveloped in the euro area, when compared to the United States, but also compared to risk-sharing within France or within Germany. In the U.S., a shock hitting one state - or a group of states - spreads more easily through the entire country than it does through the euro area. That means that such shocks can be more painful when they happen in one or two euro area countries. In particular because monetary policy in a currency union is not available to help tackle any country-specific problems. Increasing economic risk-sharing could help to prevent a country from sliding into more serious financial difficulties. In other words, more risk-sharing in the euro area would make us less vulnerable.

In the U.S. – but also inside France or Germany - risk-sharing largely takes place through the private sector: through banks, financial markets and capital flows. But Europe’s financial markets are still fragmented along national borders. That is why completing Banking Union is a top priority in deepening monetary union. Continuing the work on Capital Markets Union would be an important additional aspect to promote economic risk-sharing via markets.

Fiscal tools also help to promote risk-sharing, though – ideally - they are less needed if risk-sharing via markets works well. There are many things in the fiscal area that we do not need for a proper functioning of the monetary union. In my view, we do not need a full fiscal union. We also don’t need large additional transfers between countries. Even though the EU budget is small, only 1 percent of GDP, poor countries already get transfers from the EU budget that can be 4 percent of the size of their respective economy, which is very substantial. On top of that, the EIB and the Juncker plan already contain significant funds to promote investment across the EU.

We also don’t need additional means to deal with a large symmetric shock hitting the entire region. The fiscal rules already allow synchronized extra budget spending during an exceptionally severe economic shock. This room for manoeuvre was used successfully in response to the global financial crisis in 2009 and 2010.

Where there is a significant gap in the fiscal tools, in my opinion, is when a crisis hits not the entire region, but just one or two countries, a so-called asymmetric shock. I have often given the – hopefully hypothetical – example of Ireland if it were to be hit by a particularly hard Brexit. In that case, there would be no way for the ECB to support the country. When thinking about the budgetary aspects of deepening monetary union, a new fiscal capacity for macroeconomic stabilisation should be the first priority. It would be an important new fiscal channel for economic risk-sharing. The tool can be designed without debt mutualisation, and without creating permanent transfers. Examples in the U.S., like rainy day funds or a complementary unemployment scheme, show that this is possible. The facility should take the form of a revolving fund, not an annual budget, that would need to be repaid within an economic cycle. Shorter-term ESM loans would be one possibility for such a facility, associated with a lighter conditionality than our regular programmes. These loans could also be earmarked to stabilise investment, which is always cut first when a crisis hit.

There are several other ideas about fiscal reforms, which include an EU budget to finance public goods such as the protection of outside borders, common defence or climate change measures. This would not have much to do with deepening monetary union, but it could be very useful for efficiency reasons. Reforming the fiscal rules is also under consideration. They were easy to understand at the beginning of EMU, but have since become too complex and are hard to understand, even for experts. Finally, a euro area finance minister could be useful if there is a euro area budget, and for coordination and representation purposes.

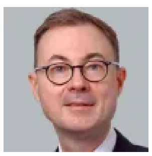
Let me come to a conclusion. I am confident that Europe can take some meaningful steps this year to make the monetary union more robust, and to better protect citizens against the impact of a next shock, which will inevitably come. For me as an economist, the main benefit would be that the euro area will then enjoy increased risk-sharing. This should happen mostly via markets, but also through a selected additional fiscal tool.

Thank you for your attention.

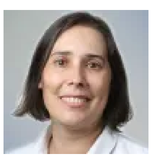
Author

[Klaus Regling](#)
Managing Director (2012 - 2022)

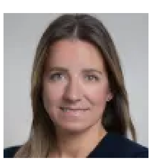
Contacts



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