“Europe will not be made all at once, or according to a single plan: European integration, the past and the future” - speech by Klaus Regling

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“Europe will not be made all at once, or according to a single plan: European integration, the past and the future”
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Ladies and gentlemen,
It is enjoyable to be visiting Dublin on Europe Day. It is the perfect occasion to look back at what Europe has achieved. And perhaps more importantly, to look to the future, and at what Europe should do next. I am also glad to have so many young listeners in the audience here. As they may be less familiar with European integration, let me begin with a brief trip into history.

On Europe Day, we commemorate the Schuman Declaration, now exactly 68 years ago. With this document, the French Foreign Minister Robert Schuman launched the idea for the European Coal and Steel Community. It was the first step towards what would become the European Union.

A part of the declaration reads like this: ‘Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements […]’. I believe this is exactly right. Today, I want to give you an idea of some of the concrete achievements made in the past, and a few we still need to make in the future.

One of the core goals of the Treaty of Rome, seven years after the Schuman declaration, was to establish an internal market in Europe, with free movement of goods, capital, services and labour. But it soon became clear you cannot get the full benefits of the internal market without a single currency. After the collapse of the Bretton Woods system in 1971, Europe went through several forms of monetary coordination. One had a very colourful name - “the snake” – and the Exchange Rate Mechanism was another. These were essential steps on the road to the euro, which brought about closer economic cooperation and convergence of the participating countries. With the introduction of the euro in 1999, disruptive changes in the exchange rates of national currencies were no longer possible. It was the start of monetary union, whose benefits include the fact that Europe no longer suffers from internal currency crises, the disappearance of transaction costs, as well as greater price transparency, which increases competition and growth. Moreover, the fact that ECB policy is conducted for the entire euro area is economically much more efficient. This is because the Bundesbank – before the beginning of EMU – dominated monetary conditions throughout Europe, but could only take the German economy into account when setting interest rates, and not any others.

Europe’s sovereign debt crisis in 2010 – roughly a decade after the introduction of the euro – brought to light policy mistakes and a number of institutional flaws in the way the monetary union had been set up. But we have fixed those now, to a large extent. So it is wrong to conclude that the monetary union was bound to fail, as some people did. Let me list the five key measures Europe put in place as a comprehensive response to the crisis.

First, and foremost, the economic problems at the national level that caused the crisis have largely disappeared. This is because countries implemented structural reforms, consolidated their budgets, adjusted wage policies and repaired banking systems.

Secondly, policy coordination across the euro area has been improved. Surveillance had mainly relied on fiscal rules, but that turned out to be too narrow. The European Commission now also has the mandate to monitor the build-up of other macroeconomic imbalances, and take action to prevent them, with the Macroeconomic Imbalances Procedure.

Thirdly, the ECB engaged in unorthodox policy measures. We all remember Mario Draghi's "whatever it takes" speech of July 2012.

Fourthly, Banking Union has made the financial sector much safer, with the Single Supervisory Mechanism (SSM) and the Single Resolution Board (SRB). Banks have doubled equity capital since the crisis, though some legacy issues still need to be dealt with.

Last but not least, the ESM is a lender of last resort for countries that lose market access, or are close to losing market access. This is a function that did not exist before the crisis. Since 2011, we have disbursed €280 billion to five programme countries: Greece, Ireland, Portugal, Spain and Cyprus. Four of the five have successfully exited their programmes since then. Greece is the only country still in an active programme, which will expire in August. The ESM will remain a sizeable bond issuer for a long time to come after that moment however, because some of our loans run over several decades, and we need to refinance them on a regular basis.

Ireland represents one of the clearest success cases of Europe's strategy to fight the crisis. I got to know the country really well, in two different capacities. In early 2010, Irish Finance Minister Brian Lenihan asked me to write a report on the sources of Ireland's banking crisis, together with Max Watson, whom I had worked with at the IMF and the European Commission. We presented our findings to the Irish Parliament in June of 2010, a few days after I had been appointed as CEO of the European Financial Stability Facility, Europe's first solution to provide financial assistance to euro area countries on a non-bilateral basis. The EFSF's main duty was to raise money for the Irish programme. This was the second capacity in which I got to know the country. I remember the day that we issued our first bond very well: we had a staff of only eight. Now we have become a bit bigger, though we are still only 170 people, a modest number for an organisation such as ours.

The crisis in Ireland showed some of the same elements that also characterised the wider euro area crisis. During the first decade of EMU, Ireland was experiencing a period of very easy credit conditions. Foreign banks were eager to lend, as competition with local banks increased. Ireland was also for the first time enjoying the lower interest rates that were the norm in core euro area countries. This led to a domestic boom and an unprecedented rise in living standards, which people expected to continue to last. In Ireland, this was most clearly seen in a property bubble and the subsequent crash. Facing an overheated economy, policymakers should have aimed for a soft landing by gradually implementing macroprudential tools and fiscal tightening. In fact, the public sector continued to spend more money, further accelerating the economy. All this was aggravated by weak banking supervision, and practices in the industry that were then widespread, but are now no longer tolerated. When the bubble burst, all this caused a severe banking crisis, at a large cost to the taxpayer.

Your country has since made a remarkable recovery. Last year, the economy grew by 7.3 percent, by far the fastest in Europe. This year, it is expected to add 5.7 percent. The unemployment rate has continued to decrease, from a peak of 15.1 percent in 2012, to 5.9 percent now. Ireland has also outperformed on the fiscal side, with a deficit close to zero last year. The debt-to-GDP ratio is falling rapidly, given a primary surplus coupled with strong growth and decreasing interest payments. The debt-to-GDP ratio fell to an estimated 68 percent in 2017, down from a peak of just under 120% in 2012.

Bond yields are subdued – spreads versus Germany are by far the lowest of any former programme country. In the regular updates through our Early Warning System, with which we measure if countries are able to pay back their loans, the ESM sees no difficulties ahead for Ireland. The fact that it has now fully paid back its IMF loans at an early stage, which has saved it more than €1.5 billion in debt service payments, is another sign of strength.

Nevertheless, there are some concerns. Volatility in the national accounts, which has led to large revisions in real GDP, is a particularity of the Irish economy. It can distort data and make it harder to assess economic performance. Alternative metrics reveal that Ireland’s debt burden remains elevated. One is for example debt-to-GNI, which strips out some of the financial flows from multinationals that are unrelated to real economic activity. Looking at it that way, debt still stands around 100 percent of the economy. Another risk specific to the Irish economy is that it could be hurt by Brexit more than other countries. The outcome of the negotiations between the UK and EU is too hard to predict at the moment, however, to gauge the possible impact on Ireland. Finally, Ireland’s economy, like many other economies in Europe and around the world, could be affected by U.S. corporate tax reform and possible trade wars.

In summary, the economic situation in Ireland is strong, even though some risks remain in place. The same is true for Europe in a wider sense. The crisis response that I just laid out in detail has made the euro area stronger, both economically and institutionally. But a look at the risks shows there can be no room for complacency.

The European economy has been growing almost at twice its potential rate for some time now, and a cyclical slowdown is inevitable at some point. The output gap is expected to close this year, and there are signs that labour markets are already tight in some countries. Also, some sentiment indicators have been easing – even if from high levels.
The risk of protectionism is highly relevant for Europe’s open economy, and is increasing under the current U.S. administration. Risks stemming from financial markets are also growing in many advanced economies: valuations are overstretched, corporate credit conditions are deteriorating, and many large banks face liquidity mismatches. Finally, cybersecurity presents a much less well-understood threat, and is therefore harder to predict. Nevertheless, its impact could be substantial.

Europe also needs to deal with a number of longer-term problems. High unemployment is a worry, particularly among young people in some countries. Europe’s low gains in productivity warrants attention, and needs to be addressed through structural reforms and investments in education and technology. Europe’s poor demographics indicate the need for high participation rates and for immigration, but this is politically difficult. Immigration can contribute to the labour supply only slowly. I already mentioned non-performing loans on the balance sheets of some banks, which are dragging down profitability, and stand in the way of greater euro area financial integration.

In short, while the recent economic performance in Europe is strong, a number of well-known weaknesses remain in place, while a handful of new risks are becoming visible. It is therefore that I urge to use the current favourable situation to fix remaining weaknesses in the architecture of EMU. We can still make a number of steps to make the monetary union more robust, and the euro area economy more resilient against shocks.

In the broadest of terms, what Europe lacks is economic risk sharing between countries inside the euro area. Shocks are shared to a much larger degree in the United States than in the euro area economy. The same is true inside large euro area countries such as France and Germany, where risk sharing is much better developed than in the euro area as a whole. Risk-sharing takes place through two channels: the market channel and the fiscal channel. The more risk is shared through banks and markets, the fewer fiscal mechanisms are needed. Improving the health of euro area banks and integrating capital markets are important steps in making the economy more resilient. Both would promote private sector risk-sharing and strengthen the resilience of the euro area in case of a next crisis.

It is precisely for this reason that the current agenda to deepen the monetary union is so important. The agenda, as you know, is currently a high priority for the finance ministers of the euro area. Its different elements all work towards the same goal: reduce the vulnerability of the euro area. In the remainder of my remarks, I will say a few words about this agenda.

European Council President Donald Tusk in December mandated the finance ministers of the euro area to work on a number of concrete steps to deepen the monetary union. This followed important speeches by French President Emmanuel Macron, European Commission President Jean-Claude Juncker, and the Commission proposal, also of December. The ministers were asked to focus on those two areas where the consensus is the greatest, and the chance of success therefore the highest. First, the completion of the Banking Union. Second, the development of the European Stability Mechanism into a more comprehensive crisis resolution mechanism. There is less consensus about any fiscal tools.
The completion of the Banking Union consists of two steps. One is the implementation of a financial backstop for the Single Resolution Fund, so that it has enough cash to deal with a very big crisis. This is a role that the ESM is likely to fulfil in the future. It could take the form of a credit line that would roughly double the

funds the SRF will have available by 2023.

A common deposit insurance is the other measure to complete Banking Union. This is still a controversial topic, because problems dating back from the crisis are more severe in some countries than in others. As long as this is the case, national banking systems cannot be expected to pool resources to guarantee depositors across borders. Also, not all national deposit guarantee schemes are equally funded. Other issues discussed under the header of “risk reduction” are the amounts of sovereign bonds on the balance sheets of some banks, differences in solvency regimes and safety buffers in the form of bail-inable capital. However, once we see sufficient progress in these areas, a common deposit insurance would have a strong role in preventing national bank runs during a crisis. Depositors simply won’t see the need to get their money out of their bank if they know that it is not just their own government backing their deposit guarantee, but all of Europe.

The second priority is the future of the ESM. Developing the mandate of the ESM is, of course, not a goal in itself. But it could be a further useful step to make the monetary union more robust. I already mentioned the first of its possible new functions, that of a backstop for the single Resolution Fund.

The ESM could also play a more important role in future assistance programme. The IMF has become less and less involved in euro area rescue packages, while the role of the ESM has increased. The ESM now has its own know-how and the necessary financial power. The ESM has not only disbursed cash in its programmes, but has been involved in important parts of programme design and monitoring. This involves debt sustainability analysis, questions of financial stability and market access. In addition, the ESM monitors developments in ex-programme countries as part of its Early Warning System.

Drawing up future adjustment programmes - designing, negotiating and monitoring them - could become a joint task of the Commission and the ESM. Clearly, any overlap of responsibilities between the two institutions would have to be minimised and the role of the Commission should be fully respected as laid down in the EU Treaty. The ESM will not play a role in economic policy coordination in Europe or in the implementation of the Stability and Growth Pact, which are responsibilities of the Commission. We also wouldn’t be involved with the Macroeconomic Imbalances Procedure. Instead, we would focus on our own strengths, analysing questions of

debt sustainability, financial stability and market access.
The ESM could also manage new fiscal facilities, e.g. for macroeconomic stabilisation. Shorter-term ESM loans, to be repaid within a cycle, with a lighter conditionality than our regular programmes, could help stabilize individual euro area countries before small problems become big ones.

Finally, the ESM could play a role in a Sovereign Debt Restructuring Framework, if Europe were to put this in place to make settlements with private creditors more transparent and more predictable. The ESM, which now has solid experience in debt sustainability analysis and is close to markets, could play the role of the neutral moderator. I am rather sceptical of the notion of introducing an automatic extension of maturities, because of the pro-cyclical effects this could have. Instead, I believe that Collective Action Clauses can still be improved in order to ease the debt restructuring process.

Ladies and gentlemen, to conclude, let me repeat the words of Robert Schuman, one of the founding fathers of the EU. “Europe,” he said, “will not be built all at once, nor according to a single plan. It will be built through concrete achievements […].” It is exactly like that with the monetary union. We have come a long way, and we are now working on some additional concrete steps to deepen the monetary union. They may not all take place at once. But the measures I mentioned are much-needed. For it is certain there will be a next crisis. Crises are unavoidable from time to time in our economic system. We just don’t know when they will occur.

If we fail to implement the agenda to deepen the monetary union now, the next crisis will force us to do so. But then, the reforms will happen at a cost that is probably higher, and under extreme time pressure. History shows that the concrete achievements Schuman talked about often took place during a crisis. But political consensus and economic tailwinds have this year created an opportunity for Europe to show it can also make progress when there is no crisis. I hope Europe does not miss that chance.

Thank you for your attention.

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