

"The ESM in a deepening EMU" - Speech by Klaus Regling

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Speeches

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"The ESM in a deepening EMU"

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* I would like to thank the Banco de España for inviting me here to talk about the important topic of completing EMU.

* This panel consists of a good cross-section of stakeholders, with representatives from two different European countries, and from two institutions involved in the euro area assistance programmes. I will give my view on deepening EMU from the point of view of the ESM, as you would expect.

* Europe has made substantial progress in deepening the monetary union since the crisis, as Paloma Marín said in her introduction. It is good to remind ourselves of that when we speak about what steps are still ahead of us.

* Europe's comprehensive response to fight the crisis consisted of structural reforms at the national level, and better policy coordination at the European level. Unorthodox policy measures from the ECB equally played a crucial role.

* In the area of Banking Union, we now have the first two pillars: the Single

Supervisory Mechanism (SSM) and the Single Resolution Board (SRB). And last but not least, the EFSF and the ESM form a crisis resolution mechanism that functions as a lender of last resort for sovereigns, a function that did not exist in Europe before the crisis.

* These changes would have been unthinkable only a few years ago. The remaining reforms are rather modest compared to what has already been achieved. But it is important that we implement them, to make the monetary union more robust and the euro area economy more resilient. Through these changes, Europe will be better prepared when the next crisis hits.

* From an economic perspective, what the monetary union needs to fix most importantly, is a lack of economic risk-sharing. Risk-sharing between euro area countries is not only underdeveloped compared to the U.S., but also compared to risk-sharing within large euro area countries such as Germany.

* The reform agenda set in motion by Council President Tusk in December tries to do exactly that: increase economic risk-sharing, mainly through the private channel, but where needed also through fiscal channels. The two elements on this agenda are completing the Banking Union and developing the ESM.

* The first step to complete the Banking Union is establishing a financial backstop for the SRF, so that it has enough cash available in case of a big crisis. There is a growing consensus that the ESM could play the role of a backstop. It could come in the form of a credit line of about 60 billion euros. But a few difficult issues are not resolved yet.

* It is clear that in a bank resolution, decisions would have to be taken swiftly, to provide the funds at very short notice. Normal ESM lending decisions take a bit longer, but a solution could be an emergency procedure similar to the ones the ESM already has in place currently. Ultimately, our shareholders must decide that is appropriate and how to reconcile the need for quick action with normal parliamentary involvement in some countries.

* Another question is whether the backstop should be used to cover liquidity needs during a crisis. These can be very high, particularly for the largest banks, and can arise overnight. Even with the backstop, the SRF would not be big enough to cover

liquidity needs in a crisis. Therefore, a solution will need to be found in which liquidity is provided by the central bank, or even the banking system itself.

* The other element to complete Banking Union is a common deposit insurance for Europe. This would have an important effect on confidence of depositors and help prevent national bank runs. A common deposit insurance remains a very controversial issue, because of legacy issues in banks' balance sheets. Reducing the amount of non-performing loans and the exposure to sovereign bonds are important in this context, but also harmonising insolvency regimes and building up safety buffers in the form of bail-inable capital. National deposit insurance schemes should also be fully funded.

* Now let me turn to the development of the ESM into a more comprehensive crisis mechanism. This is not a goal in itself, but it could also help to strengthen the monetary union. I already talked about one possible new task, that of a financial backstop for the SRF.

* It is also likely that the ESM will play a more prominent role in future assistance programmes in the euro area. Together with the Commission, it will be responsible for designing, negotiating, and monitoring such adjustment programmes. The IMF will probably continue to be involved, but its participation in the programmes has gradually diminished since 2010, and that is unlikely to reverse. The cooperation between the ESM and Commission will be without unnecessary overlaps and with full respect to the roles of the Commission as laid out in the EU Treaty.

* There could also be a role for the ESM if Europe were to set up a Sovereign Debt Restructuring Framework. This would serve to make negotiations with private sector creditors more transparent and more predictable than has sometimes been the case in the past where decisions were often taken ad hoc. The ESM could be asked to prepare the debt sustainability analysis and fulfil the role of a mediator between creditors and sovereigns, following the example of the London Club. But there should not be an automatic or overly rigid extension of maturities, because of the procyclical effects this could have.

* Another possible new role for the ESM could be to create a new facility for macroeconomic stabilisation. Such a fiscal capacity could have shorter maturities than our traditional 15 to 30 years lending and less conditionality.

- * Fiscal issues are very controversial in general, and there are many other ideas around.
- * This is probably why the organizers want to discuss fiscal issues in the 2nd panel on long-term issues.
- * Finally on legal issues relevant to the ESM, I have always been in favour of incorporating it into the EU Treaty. But this needs to happen through EU Treaty change, and not through secondary law, as proposed by the Commission. I would be in favour of a model like that of the European Investment Bank, with its own protocol in the EU Treaty, its own capital, and a board with representatives from member states. Until then, the ESM can continue successfully as an intergovernmental institution, with democratic control guaranteed through national parliaments.
- * As my final point, I would like to warn against complacency. The European economy is thriving, which may give the false impression that we have fixed all our problems in the monetary union. But that isn't the case. We still need to make the monetary union more robust, and the euro area economy more resilient. If we wait until the next crisis forces us to take the necessary reform steps, these will come at a cost that is probably higher, and under immense time pressure.

Photo: Daniel Santamaría

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