

“Strengthening the ESM and EMU” - speech by Klaus Regling

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Speeches

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“Strengthening the ESM and EMU”

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(Please check against delivery)

Ladies and Gentlemen,

It is a great pleasure for me to speak to members of parliament from nearly all EU countries, several EU candidate countries, as well as members of the European Parliament.

In my statement, I will briefly describe the events that led to the creation of the rescue funds I manage. I will also update you on the new set of tasks assigned to the ESM, which will be part of a revised ESM Treaty. Furthermore, I will show how ESM reform is part of a wider process of strengthening Economic and Monetary Union, including economic governance.

The ESM was not part of the initial set-up of Economic and Monetary Union. There

was no "lender of last resort for countries" in the euro area. The reason is simple: it was not imaginable that a euro area country could lose access to market financing and find itself on the brink of default. To be fair, nobody expected a crisis like the one we had eight to ten years ago – the worst economic crisis in Europe in 80 years.

The response at European and national level was comprehensive. Through serious and painful reforms in the Member States that received EFSF and ESM loans, as well as the unconventional monetary policy of the European Central Bank (ECB), the crisis was overcome.

At the same time, coordination of economic policy at EU level has improved significantly. And the institutional architecture of EMU has been significantly strengthened by the creation of banking union and the establishment of the two rescue funds which I manage: the EFSF and ESM.

Without the loans provided by the two rescue funds – about €300 billion – former programme countries such as Greece, Ireland and Portugal would probably have been forced to leave the monetary union. Europe would look very different today.

There is one important point that I want to stress: When granting loans, the ESM applies the basic principle used by the International Monetary Fund – conditionality. This means loans are only disbursed if the beneficiary country implements the agreed reforms.

Let me now talk about the ESM's governance. As you are aware, the ESM is an intergovernmental organisation, legally outside the institutional framework of the EU. But this does not mean that there is a democratic deficit or accountability gap at the ESM. The founding document of the ESM was signed by the governments of the euro area countries and ratified in their parliaments.

The Board of Governors, the ESM's highest decision-making body, consists of the 19 finance ministers of the euro countries. These ministers are accountable to their national parliaments. The capital behind the ESM – €700 billion – and therefore the risks taken by the ESM, are ultimately risks for national budgets.

Therefore, some ESM Members conduct national parliamentary procedures before approving ESM decisions. In addition, I am also periodically invited by national

parliaments and the European Parliament to provide updates on the ESM's activities.

Thanks to the wide-ranging measures I mentioned, the euro area today is stronger and more resilient than it was ten years ago. However, our currency union would become even more robust if we continued the process of deepening monetary union and bringing the reform agenda to an end.

Last December, the EU Heads of State and Government endorsed a wide package of reforms. This involves the completion of banking union, the further development of the ESM, and a new budgetary instrument. In June this year, the Eurogroup broadly agreed on the detailed proposals to enhance the ESM's role.

Let me describe what this will mean in practice for the ESM.

First, the ESM will provide the backstop to the Single Resolution Fund (SRF). This is a fund established by the EU for resolving failing banks in the context of the banking union. It will grow to € 55 to 60 billion. It is financed by contributions from the banking sector, so no tax-payer money is involved. In the event that the resources of the SRF are depleted, the ESM can act as a backstop and lend the equivalent amount of the SRF's own funds to the SRF to finance a resolution. Also in this case, banks would be asked to pay so that the SRF can repay the loan to the ESM.

Second, the ESM will play a stronger role in future economic adjustment programmes. In collaboration with the European Commission, the ESM will design, negotiate and monitor future assistance programmes. Of course, the prerogatives assigned to the Commission by the EU Treaty in economic policy coordination will be fully respected.

Third, the ESM's financial assistance toolbox was reviewed to make the use of precautionary credit lines more effective. They will be easier to use, which should help to prevent small problems from becoming big problems.

Fourth, the ESM could facilitate the dialogue between a euro area country and private investors if a debt restructuring is needed. And a new Collective Action Clause will be introduced that will make debt restructuring easier.

These new tasks are included in a revised draft of the ESM Treaty. The revised

Treaty will come into force when it has been ratified by parliaments in all 19 ESM Member States.

That process will start when the governments of all ESM Members politically agree on all key documents related to the ESM reform. This is expected to happen in December 2019, and then ratification should take around 12-18 months.

Since 2010, Europe has accomplished a great deal in terms of strengthening Economic and Monetary Union. However, as I already mentioned, there are still a few more steps needed to make the euro area permanently crisis-proof.

The Euro Summit in June this year mandated the Eurogroup to continue work in two areas: a common European deposit insurance scheme, and a euro area budgetary capacity called Budgetary Instrument for Convergence and Competitiveness (BICC).

It is clear that the ESM's role would be much easier with a complete banking union and a pan-European deposit insurance. With an identical level of depositor protection across the euro area and a weaker link between banks and sovereigns (i.e. sovereign-bank nexus), financial fragmentation would decrease and so would the risk of bank runs in a crisis. The volume of all the past ESM programmes would have been much lower had a common deposit insurance already been in place. The reason is that a significant amount of programme money had to be used to recapitalise the banks in the programme countries.

These are strong reasons to create a European deposit insurance. For this to happen, euro countries need to agree on a mutually acceptable balance between risk-reduction and risk-sharing. This implies that legacy problems in some countries must be tackled - meaning a further reduction in non-performing loans and a re-balancing of banks' exposure to national government bonds in their balance sheets.

As for a euro area budgetary instrument, the current focus is on improving convergence and competitiveness in euro area countries. Of course, it is positive to allocate budgetary resources to an improvement of convergence and competitiveness.

But in my view, it would also be useful to think about a tool for macroeconomic stabilisation for the euro area. It would be used in the case of economic shocks

affecting one individual country – for example, if Ireland was hit by a hard Brexit. Such a facility would not be an annual budget, but a revolving fund, and there are various ways to establish this.

Rainy day funds or a reinsurance of national unemployment insurance – which exist in most US states – are some options. All these schemes would not lead to permanent transfers between the participants. Rainy day funds, for instance, pay out during a crisis, but states reimburse the money when they recover. A short-term ESM facility with lighter conditionality could play a similar role.

Looking at possibilities for improving governance in the monetary union, I am in favour of integrating the ESM into the EU Treaty – but only through a change in primary law. When the EU Treaty is changed one day, the ESM could be integrated in the same way as the European Investment Bank (EIB). The EIB is an institution with its own capital and a Board in which the shareholders are represented. This would work well for the ESM.

I would like to thank you for your attention. I look forward to hearing the views of Marco [Buti] and Olli [Rehn], and to our discussion.

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