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J. de Larosière Lecture: Wolfgang Schäuble

Speakers

Wolfgang Schäuble
Germany , Federal Minister of Finance

Wolfgang Schäuble

Ladies and Gentlemen,
It is a great honour for me holding the very first lecture with the name Jacques de Larosière in its title. It is the appreciation for a man with a long and impressive list of contributions to policy debates and policy solutions. There are few men (and women) in Europe and worldwide who have served the public good in so many different fora like Jacques de Larosière did.

Educated as a lawyer he did his way through a world of economists. This makes him applaudable. He directed Le Trésor in Paris, the IMF in Washington, the Banque de France in Paris and the EBRD in London. This makes him universal. And based on his experience, as Eurofi President he built reliable bridges between the public and private sector, which makes him unique. I may add that under his Presidency in the nineties the EBRD very much benefited from Jacques` strict financial consolidation course and focus on SME financing, which makes him German.

Against this background my Minister Wolfgang Schäuble very much regrets for not being able to give this speech himself. My Minister would have loved exchanging views on the past, the present and the future of Europe and the Eurozone with such a distinguished man and audience. So my humble role today is to deliver some thoughts on where we are and what we have to do. Let me already try an early summary: Competing with an increasing number of regions in the world, we as Europeans have to draft and defend a European narrative which delivers a clear picture of Europe and the Eurozone as learning, reform-oriented and predictable region that national citizens as well global investors can trust. The Euro is not a single currency. Our real currency is confidence.

Europe has a long history. We have to learn from the past, even if learning processes are long, thorny and painful. During the economic and financial crisis the Euro Area showed what is possible if its member states act decisively: We sharpened the Euro Area’s fiscal rules, advocated overdue structural reforms and strengthened European financial markets. Over the course of the last seven years, following the collapse of Lehman Brothers in 2008, we have reformed Europe’s fiscal and financial rulebooks.

The most important financial reforms include the introduction of higher capital requirements for banks under Basel III, the new rules for bank resolution, including bail-in instruments – to better protect European tax payers.

We together had been able to demonstrate to the world that Europe is able to evolve and reform its institutional frame by establishing the Single Supervisory Mechanism in Frankfurt and the Single Resolution Mechanism in Brussels. In parallel, we as Europeans have helped to foster the international financial architecture by strengthening the G20, the Financial Stability Board [FSB] and the International Monetary Fund. In particular, the FSB carries out an effective coordination between the various international standard setters and is in close touch with policy makers at the G20 levels as well as the specialist committees – such as the Basel Committee on Banking Supervision.

Of course, the European and international landscape still shows regulatory and supervisory gaps and lacunae, since G20 or FSB reforms are not always consistently implemented by countries. Therefore, there are still plenty of regulatory alternatives, which are taken advantage of by financial institutions, the so-called forum-shopping.

However, in Europe financial market regulation has significantly increased regulatory harmonization. Numerous directives and regulations have been adopted – most importantly the Single Rule Book and the directives and regulations regarding the European banking union. In particular, there are fundamental changes regarding banking supervision, banking resolution and deposit guarantee schemes in Europe as well as stricter provisions for capital and liquidity requirements and compensation systems. If I recall the early days of Eurofi after the year 2000 (when I became a supervisor) and compare our past discussions on convergence of regulation and supervision with today, Europe has become a much safer and more coherent place to be.

Learning from the past never stops. It is an everlasting process. Our goal – managing/reducing risks in the financial sector – will occupy us in the coming years as well. We have to make the “bail in” as effective as possible. Only if resolution mechanisms are credible, we have the “too big to fail” problem under control. For systemically important banks we therefore need credible and binding minimum standards to ensure a sufficient capacity to absorb losses. Only when we reduce the risks of moral hazard and introduce additional risk reducing measures (including an adequate regulatory treatment of sovereign risk), it makes sense to think about additional risk-sharing such as a Common Backstop for the Single Resolution Mechanism.

Regulation is not an excuse for poor policies of individual financial institutions. I am aware that the situation for many banks but not only banks, due to the cost of new regulation, low interest rates and the emergence of new competitors like FinTechs is not easy. But the outlook for European banks varies a lot, which shows clearly, that some business models might not be well thought out.

I believe that, due to our reforms, the overall stability of the financial system has improved, but serious risks persist that may lead to excessive market volatility –among them, first and foremost, high public and private debt levels.

Indebtedness has shifted from industrialized nations to emerging economies and from the public sector to households, businesses and financial institutions. So, although the composition of debt has changed in the last few years, debt levels continue to rise. Rising levels of borrowing have in recent history been accompanied by an increase in the number of financial market crises and declining growth rates.

A second risk facing financial markets is the shift of global credit intermediation from the banking sector to many different forms of market-based financing, some of which can be viewed as problematic types of shadow banking. While an increase in non-bank financing may indeed benefit the real economy and we are all eager to complete the CMU, good regulation of the shadow banking sector is essential to prevent regulatory arbitrage.

Third, the current period of low interest rates puts financial market stability at risk. If this situation continues for much longer, the demand for high-risk investments will continue to rise. The pursuit of higher returns may result in the mispricing of risk, which could in turn lead to bubbles and inflated asset prices.

To be clear: No one questions the independence of the ECB. Bur I believe we should be able to discuss possible secondary effects of monetary policies.

The low interest rate policy or rather the negative interest rate policy can be seen as a matter of concern in another respect. There is an obvious trade-off between the ECB’s interest in solid major financial institutions and the ECB’s pursuit of low interest rates to reach its inflationary target. In other words, the requirements of banking supervision and monetary policy can collide. The collateral damage, which can result from mixing both, might turn out to be greater than the benefits. And we haven’t even begun to talk about the fact that low interest rates allow unprofitable companies to continue as zombie companies, kept afloat by low interest rates.

We as Europeans together with the G20 have several times, last time last week in Washington, stressed the fact that monetary policies by themselves cannot achieve balanced and sustainable growth. The extent to which the instruments of monetary policy stimulate economic growth in Europe is open to question. The willingness to invest obviously depends not solely on how cheap or expensive capital is. Other factors appear to play a key role – including robust fiscal and economic policies –, which is another way of saying that European governments need to be willing to tackle necessary structural reforms - to foster confidence.

Unfortunately, some declining willingness to advance the consolidation of public finances and to carry out reforms seems to be another side effect of the current low interest rate environment. This is more than unfortunate, because the impact of the fiscal and structural reforms introduced in the course of the last seven years is obvious: Euro Area member states that took ownership of their economic adjustment programs as a condition for financial assistance, restored the sustainability of their debt trajectories, their competitiveness, and started to grow again. I could give you not yet five, but four good examples.

As a result, there are signs that continuous confidence returns to consumers, investors and businesses of the Euro Area. If we avoid the mistakes of the past - and with a bit of luck - the Euro Area has entered an era of modest, but sustainable growth. This is why we now have to keep course to be credible in our reform efforts.

Of course it is true that the willingness of most member states to enter a grand bargain for major changes of the Euro Area treaties for the better is currently low given the challenges and risks surrounding us. Therefore, we must also focus on what we can achieve within the existing framework. There is a lot which can be done in a more integrated approach:

First, the EU budget could be geared towards supporting the necessary reforms in the Member States. Second, the European semester as an essential instrument of economic governance should be further strengthened, and work is ongoing on this. Third, the capital market union could enhance the common market. But back to the first point, let’s talk about money - the EU-Budget.

The time is right to get rid of our old habits. The existing financial buffers of the Multiannual Financial Framework are almost used up. If we want to finance our policy objectives while respecting the existing expenditure ceilings we have to set new priorities for our budget. This year the Commission will present the mid-term-review of the Multiannual Framework. The Commission should use this opportunity to submit broad proposals – not to put into question the ceilings of the financial framework. What we need are proposals to improve the effectiveness of the EU budget, proposals which better link Europe’s spending with economic governance and reform efforts.

The EU budget – which today amounts to nearly €150 billion per year – can make a difference, much more than it does today. For the funding period from 2014 to 2020, we have nearly €1 trillion available to implement European policies. But over 70 per cent of the €1 trillion in the current financial framework is being used to replace national spending, which means that European money is financing non-European policies.

If we want to improve the way we spend the money of European taxpayers, we have to spend money with a view to generating European added value. Foreign policy, migration policy is a spending priority with a high European added value. We have just learned that the protection of Europe’s external borders is a task which cannot be ensured at the national level alone. If a member state with an important external border needs assistance Europe should provide - and finance - it in its own interest.

A second example where we can perform much better is the area of country-specific policy recommendations to identify the main economic challenges for each EU Member State. If we are really committed to these recommendations, the EU’s budget should support the respective member states to implement these recommendations. National projects which profit from financing by the European funds should be designed to implement the country-specific recommendations. The Commission needs to make this a precondition for the financing of national projects. An approach of this kind, which is based on the synergy effects between the implementation of the country-specific recommendations and the use of EU funds, would have a positive effect on the public image of the EU as an agent for active change - rather than an obstructionist. An integrated policy approach consisting of European money and structural policies would in addition facilitate clear communication of existing and future political priorities.

Germany supports shifting European spending from outdated priorities towards supporting reform-oriented policies - policies that foster sustainable economic growth. Another important step towards the long-term strengthening of growth is reactivating investment activity in the whole of the EU. High debt levels limit Member States’ options. Hence, the priority must be placed on private-sector investment. This represents the bulk of investment in volume terms. You as representatives of financial markets know this quite well. Therefore, it is essential that the conditions for investments are continually improved through carrying out appropriate structural reforms, as foreseen in the third pillar of the Juncker Plan. I hope we can rely on a proper feedback loop from investors on existing deficits in good investment climate.

In order to be attractive to domestic and foreign investors, not only Euro, but all EU Member States must have competitive framework conditions and a well-functioning legal system. In addition, they must also eliminate sector-specific barriers to investment. To this end, the country-specific recommendations themselves should play a crucial part again: They must focus much more intensively on the improvement of national investment climate and conditions. The “Doing business” Ranking of the World Bank gives you a first flavour of where we are. In this policy area too, the desired greater use of benchmarking among Member States, which has been rightly launched by the Eurogroup President, is essential in increasing political peer pressure especially between Euro countries - focusing the overall debate more intensively on the necessity of reforms and the responsibilities of Member States once again. The functioning of national insolvency regimes is a good example. Being relevant for Banking Union as well as CMU.

By the way: European approaches should not be an excuse for member countries to distract from the need for reform in their own country. The Member States can also make a contribution through setting the correct priorities in their budgets. I do believe we need to have a more intensive debate on the quality and not the quantity of public finances. Size does not always matter.

You can see: There is no quick fix to deepen the Union. Nevertheless, I am confident that we can create the basis for a stable and prosperous EMU through many small steps. The key question remains: How do we enhance the resilience of our economies? Since challenges differ among countries, the necessary adjustments are different, too. In concluding, there are three principles, which, if adhered to, help countries to cope with shocks and grow in a sustainable way.

First, we need to address excessive private and public debt. High levels of private debt lead to more market volatility and increase the risk of future crises. Nobody can exclude future debt crises. High levels of public debt prevent us from creating new fiscal buffers. Fiscal buffer and fiscal space for souvereigns work like equity in financial institutions. They allow us to act in case of future crises.

Preventing the build-up of excessive debt is therefore of utmost importance. We have to strengthen the credibility of our fiscal policies by putting debt on a downward path. I would indeed welcome if we had an increasing consensus on how to prudently manage public lending and borrowing.

Second, we should go forward with structural reforms that improve the resilience of the real economy and create a favourable investment climate. By doing so, we have to aim for more flexible labor, product and service markets – throughout the EU.

Third, the more we modernize our structures and foster growth, the more we can build a bridge for monetary policies to return to normalization. Hopes for simple solutions through expansionary fiscal or monetary policy have proven to be misguided. Debt-driven economic growth is neither sustainable, nor does it strengthen resilience. Instead, boom-bust cycles harm productivity and sustainable growth.

Fourth, I have elaborated on that, we need to continue with our financial market agenda and regulation agenda. I know that many dream of significantly reducing the regulatory burden. I am afraid, I have to disapoint you. Evaluating the burden is good. Transitional arragements are good as well. But as former President of BaFin, Jochen Sanio, said: “You will never walk alone.” Sound regulation and supervision ensures financial stability and sufficient financing for the real economy.

To cut a long story extremely short: A bulk of work ahead of us. A failure of Europe is not an option, as my Minister uses to say. I am sure that David Wright, as former Commission official and Secretary General of the International Organization of Securities Commissions will share this view in his new role as President of Eurofi. We will all monitor whether David will follow Jacques` career in a reversed order: Eurofi President now, then EBRD President, finally ending up as the French Directeur du Trésor. This would be a truly European success story. David, all the best!