Sabine Lautenschläger: Fostering global growth

Speech by Ms Sabine Lautenschläger, Member of the Executive Board of the European Central Bank, at the panel during the G30 International Banking Seminar, Lima, 11 October 2015.

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I would like to thank Jacob and Jean-Claude for inviting me to participate in this panel. You will not be surprised that I will focus on the growth challenge faced by the euro area countries in my intervention.

Let me stress from the outset that I believe that the euro area can make a much stronger contribution to global growth than it has done so far. But for this to happen, we need a stronger reform impetus in many euro area countries.

To substantiate this claim, I would like to address two questions: first, where do we stand on growth and reforms in the euro area? And second, which structural reforms are still needed to support stronger and sustainable growth?

Where do we stand on growth and reforms in the euro area?

Growth has been recovering in the euro area, albeit at a modest pace.

Output growth has been gathering pace throughout 2014 and in the first half of 2015 and employment has been increasing.

However, developments are still uneven across member countries and it is not clear that the recovery can be sustained in the medium term.

Our main concern is that across euro area countries domestic vulnerabilities are still very large, which implies a limited ability to withstand adverse external shocks and to kick start a new phase of sustainable growth. The vulnerabilities of many euro area countries are related to the high stock of debt, both public and private, and to a number of structural rigidities and institutional bottlenecks that prevent an optimal allocation of resources across factors of production, and thus limit total factor productivity growth.

The current environment not only urgently calls for the implementation of structural reforms, but also provides the right conditions for their implementation. With our monetary policy, the ECB is greatly contributing to an environment favourable to implementing structural reforms: our accommodative monetary policy stance helps countries to gain time, time to implement the necessary measures to increase resilience and thus support sustainable growth.

However, there is only a limited role for demand-side policies. Fiscal space is limited and monetary policy cannot carry the burden of the adjustment alone. For the euro area to become more resilient and sustain stronger growth, national governments need to bring about further structural change[1].

Work in this regard has already started, and the reform wave of the countries hardest hit by the crisis is showing some initial results, such as a GDP recovery related to comprehensive labour market reforms. Other reforms, mainly on product markets, are expected to bring about GDP gains, but they need to be implemented in full.

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1 See ECB, "Progress with structural reforms across the euro area and their possible impacts", Economic Bulletin, Issue 2 / 2015.

However, since 2013, very low financing costs for sovereigns and rising share prices have eased the pressure to implement more difficult policies[2]. By definition, for structural policies to be most effective, a long-term commitment, continuous implementation and strong reform ownership are needed. This is the only way to permanently change expectations and growth prospects.

This leads me to our second, more concrete, question:

Which structural reforms are still needed to support stronger and sustainable growth?

To start with, let me stress that all euro area countries, albeit to different degrees, still need to implement structural reforms.

There are a number of credible reforms that are able to increase permanently total factor productivity; to affect confidence; and to help reduce uncertainty and increase investment and sustainable demand.

In particular, for the euro area I see the need to forcefully work on:

1. reducing red tape – by easing licensing procedures and facilitating access to credit by viable firms;
2. improving the judicial systems – including the effectiveness of insolvency regimes;
3. increasing the efficiency of the public administration and tax systems;
4. reducing entry barriers in sectors sheltered from competition; and
5. reducing hiring costs and skill mismatch.

These reforms would unlock immediately "hidden" demand, increase economic resilience and facilitate the working of monetary policy.

Among these reforms I believe that particular attention needs to be given to all legal, administrative and bureaucratic impediments that can lead to an increase of the overall costs for debt workouts, make the distinction between viable and non-viable firms more difficult, and hamper firms' exit from and entry to markets as well as investment.

In concrete terms, this means improving the efficiency of insolvency regimes.

In corporate debt restructuring, experience to date shows that an effective insolvency regime is critical to facilitate the early rescue of viable firms and the speedy exit of non-viable ones.

IMF analysis also shows that weak debt enforcement and ineffective insolvency frameworks tend to lower the recovery values of problem loans[3]. Our internal analysis finds that in order to be able to cope with high private debt ratios and to deleverage reasonably quickly, the strength of the insolvency framework is important. Also, recent analysis from the European Commission found evidence that in the presence of a high stock of private debt, the quality of insolvency frameworks is important for financial stability and for spurring entrepreneurship and thereby mitigating the impact of deleveraging on growth. In particular, it was found that a good insolvency framework is associated with speedier adjustment of non-performing loan ratios.[4]

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[2] See OECD, "Economic Policy Reforms 2015: Going for Growth", 2015.

[3] Aiyar, S., Bergthaler, W., Garrido, J. M., Ilyina, A., Jobst, A., Kang, K., Kovtun, D., Liu, Y., Monaghan, D. and Moretti, M., "A Strategy for Resolving Europe's Problem Loans", IMF Staff Discussion Note, September 2015.

[4] Carcea, M. C., Ciriaci. D, Cuerpo, C., Lorenzani, D. and Pontuch. P., "The Economic Impact of Rescue and Recovery Frameworks in the EU", European Economy Discussion Paper No 004, September 2015.

To highlight the differences in insolvency frameworks across euro area member countries, let me mention a few country figures: in Slovakia it takes on average 4 years to resolve an insolvency case, while in Portugal it takes 2 years and in Ireland it takes less than 5 months.

When looking at international practices, one can find three types of procedures through which firms can deal with debt restructuring:

1. out-of-court procedures;
2. hybrid preventive restructuring procedures; and
3. formal insolvency or restructuring procedures.

In the euro area countries formal insolvency procedures are very common, while out-of-court procedures have been much less used so far. However, voluntary out-of-court restructuring can provide a speedy, cost-effective and market-friendly alternative to court insolvency proceedings. This tool is particularly useful in cases where there is a lack of confidence in the institutional capacity to support the operation of the insolvency system.

In the past few years insolvency laws have been amended, in particular in Spain, Italy and Portugal, to better support early rescue of viable firms, to help the deleveraging process and to free up resources for further investment and thus productivity growth. I believe that these reforms, if the effort to implement them continues, will help us to grow out of the current high private sector debt problem.

Of course, there are other possibilities and the list of potential reforms is long. I could elaborate further, but my time here is unfortunately limited so I chose to constrain myself to this crucial area of structural reforms.

Conclusions

Let me now conclude. As I said at the beginning, the euro area can make a much stronger contribution to global growth than it has done so far. The conditions are very favourable for a strong push for reforms; in particular, our monetary policy stance is supportive.

Reforms should now focus on boosting productivity and reducing the burden of the high debt stock. Work in this direction has started and is ongoing, but the euro area governments need to continue on this track with more determination and impetus.