Interview with Naftemporiki

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Interview with Klaus Regling, Managing Director, ESM

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Conducted by Athanasios Adamopoulos

Q: The IMF has questioned the agreement made at the Eurogroup last month. Mrs. Lagarde, in fact, replied “what debt relief?” when asked about debt relief for Greece. And, at the same time, credit rating agencies seem to share the views of the IMF they have not made any move on the Greek sovereign debt so far. What do you think is happening?

A: Well, first let me clarify a few things on debt relief. Greece already received a lot of debt relief in the past. Private creditors accepted a haircut of more than fifty percent in 2012. And the official creditors improved the terms and conditions of lending a lot by extending maturities, reducing interest rates and by eliminating fees and margins. Taken together, this amounted to a 40% debt reduction in so-called NPV terms, in net present value terms. This already happened and this continues to benefit the Greek budget and the Greek economy. We have made calculations for the ESM Annual Report that was published last week. Based on certain assumptions, the Greek budgetsaved around 8 billion euros in 2015 thanks to our favorable lending terms. That corresponds to around 4.5% of Greek GDP and this happens every year.

At last month's Eurogroup meeting, the euro area finance ministers decided that they are prepared to provide additional debt relief. First they agreed on a framework together with the IMF. According to that framework, it is helpful to decide on

additional debt relief “if necessary”. The ministers gave the ESM a mandate to implement in the first step short-term measures that we can implement immediately and we will do that this year. That means smoothing the repayment profile of Greece. That will be helpful, because we know in certain years Greece will have particularly large amounts of debt repayments. In other years it is much less. We also received the mandate to reduce interest rate risk. And on a certain tranche of old debt there was an increase of the interest rate margin in 2017 that will now be waived. So these things will happen on top of what already happened in 2012. Whatever happens beyond that will be decided in the future. But there is a clear commitment from
the Eurogroup that additional debt relief will be made available if needed and if the Greek government continues reforms. So this is the agreement and the IMF was part of the agreement.

Q: The IMF, however, insists that all debt relief measures should be upfront. On the other hand, European partners have mandated that the ESM have a three-step approach to this: short-term, medium-term and along-term. You said that the short-term action is immediately available.

A: Yes, because we already received the mandate from the Eurogroup, so we will do it. That is agreed and there is no doubt about that.

Q: Have you planned something for this year?

A: Yes, very likely, almost certainly yes.

Q: Does this also include the repurchase of IMF loans to Greece by the ESM?

A: No.

Q: Could this be an idea in the future?

A: This could be a medium-term measure but there is no final decision on this yet.

Q: Does the Greek government have any say on this process?

A: Of course. When we discussed these measures in the Eurogroup and in the Board of Directors of the ESM, when we tried to find the most appropriate solution, Greece was always there. Greece is part of the discussions; Greece is a member of the Eurogroup, of the Eurogroup Working Group, of the ESM Board of Directors. Of course, Greece has a very important say, because we don't want to do something against the wishes of Greece. We want to come to a good solution together with Greece. And I think there is a very important difference with the IMF. The IMF normally has a shorter timeframe than we have. And I think that explains some of the differences in views. When the IMF goes to a country and provides loans-and they have been doing that successfully for more than 50 years-there is no other source of financing. In such a case, if a country loses market access, only the IMF is prepared to provide new financing. And the IMF only provides financing for up to 10 years. So the IMF has to make sure that by the end of the program, debt sustainability is regained. That has to happen relatively quickly. But in Europe, we have created a new framework with the EFSF and ESM: Our lending in the case of Greece is for 32 years and that changes the situation quite significantly. We have a lot more time. The country, Greece, has a lot more time. We don't need to decide everything upfront. We can fine-tune the degree of debt relief and the kind of debt relief and adapt it to the real developments in the economy over the years. In our framework, it would not be appropriate to decide everything upfront. Taking decisions upfront is very appropriate for the IMF in other cases outside Europe, where there is a very short period of time when everything has to be back to normal. We have more time. That is good for Greece. It is good for the Greek economy that we have more time together. It also shows the commitment of the Eurogroup and the ESM. The ESM will be in Greece for several decades. Therefore we can decide as we move along how much debt relief is needed. Maybe it's less than we think at the moment, less than the IMF thinks, maybe it's more. There is a lot of uncertainty over such long time periods. Even when we make forecasts for next year we always know that there are uncertainties. Now that we are thinking about the next ten or twenty years, the degree of uncertainty is of course much higher. But the commitment of the Eurogroup is clear. We will continue to help, if needed, so if more is needed, more will be provided. And if less is needed, that's also good for everybody. So I think this is an appropriate commitment, given the framework in which we operate. That framework is very different from the normal IMF framework.

Q: However, if you look further in the future, there is a risk of losing some of the benefits that the current environment offers, such as the ultra-low interest rates, or even the fact that IMF has 14 billion euros in loans to Greece and by 2018 it will only be 10 billion. So the benefit will be less, if

we decide, if you decide to do something later.

A: On the first point: The issue of low interest rates is addressed by the ESM in the short-term measures. The ESM received the mandate from the Eurogroup to work towards reducing the interest rate risk for Greece. That means locking in these low interest rates for longer. We are working on that together with the Greek government...

Q: Sorry, so we are talking about locking interest rates, they are not floating, they are fixed?

A: Well, you have to understand how we operate. We issue all kinds of paper, from very short-term to very long-term. We put all the money that we raise in the market in one pot; it is one pot of money. And the average maturity of that money–an average comprises paper from three months to forty years–is at the moment seven years. And the interest rate on average for everything we do is 0.8% at the moment.

So, we can lengthen the maturities by issuing more long-term bonds or we could work with derivatives to lengthen the maturity. We cannot lock in interest rates for forty years because the market is not there. But we can lengthen the maturities and that would reduce the interest rate risk.

Regarding the IMF, you mentioned a number which is at the moment 14 billion euros in outstanding IMF loans. That is a relatively small amount. After the ESM disbursement of 7.5 billion euros, we have disbursed loans from the EFSF and ESM of a total volume of 170 billion euros. That's a different order of magnitude. The maturity of the IMF loans is short-term. In the next two years, the 14 billion will go down to 10 billion, unless the IMF makes new disbursements to Greece. The problem that interest rates on the IMF share of Greek debt are high will disappear anyway. Please note that according to the decision of the Eurogroup, we will look at the possibility of reducing IMF exposure further at the end of the programme.

Q: The IMF has already backed down from its initial demand for a "debt haircut". Instead, now they accept the European side's proposal for re-profiling, debt maturity extension and all that. Do you think that there will be a compromise on the latest European offer?

A: We will sit together again later this year. We will all do another round of debt sustainability analysis when we have more data. Some differences between the IMF and the European institutions including the ESM are that we are slightly more optimistic on economic developments in Greece. The ESM shares this consensus of European institutions. By the end of the year, we will know better if this is correct or not. We know forecasts are uncertain and each one has to work on forecasts and prepare forecasts. I have done that for many years. We all know that there is uncertainty. Therefore, I am not saying that the IMF's forecasts are wrong. They may turn out to be right at the end, but at the moment the European institutions believe that our forecast is the right one. Some of that disagreement will disappear. But there are still different views on the longer-term growth potential in Greece. And this will also depend on the reforms that are still pending and the effect of these reforms on potential growth. As time goes by, we will know better. That is the reason why it is quite appropriate not to decide everything upfront, but decide as we move along.

Q: As an economist, when do you expect the effects of these reforms to be visible in the real economy?

A: They already became visible in 2014. When you think back to 2014, there was positive growth, unemployment started to fall in 2014 and the government was even able to issue bonds in the markets again. That was the beginning of a positive trend. Then the reforms were interrupted in the first half of last year. The government tried a different approach, which I think was not good for economic developments. But since last summer we had again good cooperation, reforms continue with the current third Greek programme which contains many frontloaded economic reforms. These reforms will show their economic impact; I have no doubt on that. We know from many countries around the world: the more structural reforms countries implement, the better the medium and long-term prospects.

We've seen that in many IMF programme countries like Turkey, Brazil or Asian countries during the Asian crises. At one point in the past, they had serious crises, very painful adjustments, but a few years later their growth performance became very positive as a result of the adjustments. The same is now happening in Europe. We have countries like Ireland and Spain that went through EFSF or ESM programmes. Today they have by far the highest growth rates in Europe. In Ireland last year the growth rate was almost 8%, unemployment has been cut in half. In Spain, we saw growth rates of more than 3%. We also saw employment gains of 3%, It is not surprising for economists to see that was has worked elsewhere in the world also works in Europe. After good reform implementation, growth prospects improve tremendously. Unfortunately, it takes a few years to get there. We know the forecasts provided by the institutions that growth in 2017 and 2018 in Greece will be quite significant. It’s a very precise number: in 2017 we expect 2.7% growth under the programme and in 2018 3.1%. So this is significant improvement. With the full implementation of the agreed reform packages, this is a very realistic expectation. There may be even positive surprises. As a result of the reforms, the economy will become more efficient, more productive and that will improve growth prospects and employment prospects.

Q: Since the crisis began in Greece and the memorandums signed, I recall that European partners were focusing on the need for the government to take ownership of its agreement. Do you feel this current government has taken ownership of the agreement?

A: Compared to a year ago, the situation is completely different. We work very well together with Finance Minister Euclid Tsakalotos. Also, the prime minister is very committed, though maybe not every minister of the cabinet is equally committed. Ownership is very important. In the context of the first review of the third programme, many important new laws have been adopted in the parliament: the pension reform, new institutions have been create d, like the Revenue Secretary, the Privatization Fund, now called the Hellenic Assets and Participations Fund, is starting. All this now needs to be made operational. The decisions need to be implemented and that requires ownership. Ownership and implement ation will determine the prospects of the economy in the future. The better that works, the better the prospects.

Q: There is another topic of interest, the targets for primary surpluses, 3.5% in 2018 at the end of the programme. And over the last two weeks we’ve been hearing European officials, like Mr. Dijsselbloem or Mr. Moscovici, or yesterday Mr. Macron, the French minister of economy, opposing the continuation of primary surpluses. And at the same time, the IMF says that these kinds of targets are not sustainable. Could you see that, at some point, this will change, I mean from 2018 and thereafter?

A: This was something that was agreed at the summit in July last year. It’s the highest level, the heads of state and government. Prime Minister Tsipras and the other 18 heads of state and government of the euro area agreed on that and signed on to it. From the ESM perspective, I have no reason to believe that this would change. The agreement says that the primary surplus should reach 3.5% in 2018 and in the medium term. That means also for some time after 2018. It's not agreed exactly for how long, but I don't think it will be just one year. That would not be what was agreed last summer. But the exact length of time is an open issue. That's one of the points that need to be clarified when we return to this issue, also in the context of talks on debt relief later in the year.

Q: You have, because of your work, contact with institutional investors from around the world; I assume you discuss Greece at some point. What is their impression about Greece and what Greece needs to do to get back some productive investments?

A: One of the core activities of the ESM is to mobilize funds. We can only give a loan to a country if first we issue bills and bonds in the markets and investors buy these papers. That's why I am in permanent contact with large investors around the world. Of course, they have views and questions on Europe and they have views and questions on Greece. They look very carefully at what is happening. They also see that in the first half of last year, there was a big interruption of the reform process. They realized that in 2014, the first positive signals of success became visible. The country was still suffering from a loss in employment and from a reduction of income. But economists and investors could see positive signals in 2014. And they also saw very clearly the problems during the first half of last year. Some reforms were reversed and there was a stop in new reforms. They continue to follow the situation in Greece very closely. They recognize that a new attempt is being made, that indeed this programme is frontloaded and that many important initiatives have passed through parliament. That is positive. But investors are now waiting for implementation. Sometimes they get different signals from different members of the cabinet, from different politicians. So they are waiting for implementation. I think then they are prepared to come back to Greece if the programme is fully implemented as agreed. The government's intention to go back to the markets in 2017 is quite realistic, I think that is possible. But it will be more important to attract greenfield investment, not only financial investors. Greenfield investments will create new jobs and the econom y can return to a healthier situation. But the investors need to be confident that the implementation is really there, they need more confidence than the financial investors. Financial investors come first, but they can also disappear very quickly if somet hing goes wrong. For greenfield investors in the real economy, it is very difficult to get out quickly. Therefore, the level of confidence must be higher. That can only be achieved through very credible

implementation,
through ownership of the entire government.

Q: Let me get to another point. You made what I call a political statement last week, when you said that regardless of the referendum in Britain, Europe should proceed with integration at different speeds. Why now? These discussions have taken place in the past already and clearly your remarks were not targeted to the British voters.

A: This was not targeted at the British voters at all. I'm convinced that what we have seen in the past will continue. This two-speed or multi-speed integration is not new at all. There is the euro, Schengen and other examples. They show that there is an inner core that is willing to integrate 6 faster than the rest of the European Union. It is important that this remains open, it should not be a closed shop. Countries should be able to join when they are ready. We have seen that happening, in the euro area for example. Even during crisis years, the euro area has grown from sixteen to nineteen countries. When the euro area started we were only eleven. So I believe this is a good way of proceeding: those more willing to integrate go ahead but we remain open for others to join later. That's a good process. If we wait for the last one of the 28 EU member states, then we will not get very far. Of course, one has to be very careful. We have to recognize that in most countries today, the appetite for more European integration is very small. So I think we have to analyze very carefully the few key areas where more integration is really needed, because it would benefit everybody. But we should also look at areas where less integration is needed, where the subsidiarity principle could be respected more. The EU could also give back some competencies to national governments. But in a few areas I think it is important to continue integration. When I look at monetary union I think there are a few areas one can identify. But let us also acknowledge that a lot has happened in the last five to six years, more than anybody expected in 2010. We created new institutions, like my institutions, the EFSF and ESM, but also banking union, and all the institutions linked to that, the SSM, SRB, SRF, the European Banking Authority. We have the ESRB. Banking union is a very important step for the good functioning of monetary union. Also, we have new and better coordination frameworks in place, for instance the Macroeconomic Imbalances Procedure, which didn't exist before the crisis. So we have come a long way and if we apply all these new rules in a good way, then I am convinced the monetary union already functions better than before the crisis. But a few things could still be done: completing the banking union, tackling capital markets union, maybe thinking about a limited fiscal capacity. These

are a few important items on top of what
already happened. But one can also think of other areas of the EU where activities are less needed. I don't want to create the impression that we need a lot more Europe everywhere. That's not needed and I realize also it's not what the population wants.

Q: So, you exclude the possibility of political integration.

A: What we have seen the last six years has moved us closer to a political union and a fiscal union. But I don't think we need 100% political union and 100% fiscal union to make monetary union work successfully. We have come a long way in this process; we have more political union today than six years or twelve years ago. I don't think we need a lot more to make the monetary union more robust. I don't think we need a United States of Europe as a precondition to make the monetary union successful. What we need is that the agreed rules are implemented, including the new rules that we have, make banking union a success by completing it and all that will help a lot.

Q: Talking about banking union, there is talk that Greek banks may need more capital after the resolution of the non-performing loans issue. Do you think that this could lead to another recapitalisation process?

A: The SSM has analyzed the situation. There was another Asset Quality Review and a stress test for Greek banks at the end of last year. The result was a positive surprise. We had in this third Greek programme 25 billion euros earmarked for Greek banks. In the end we only needed to provide 5.4 billion euros. It will also help the Greek economy. It means 20 billion euros less debt, which is almost 10% of GDP. So that is very positive. And I don't know more than the SSM. I also realize that sometimes situations change. And not everything can be foreseen. There might be another situation 7 where capital might be needed, but I'm not aware of that at the moment and I don't foresee that. I have a lot of confidence in the SSM and their analysis at the end of last year. Of course, it will also be very important that the NPL framework that was adopted in parliament is really fully implemented. As we discussed earlier, implementation is now the key. Many important steps have been taken in parliament and the NPL framework is one of them. And the more successfully it is implemented, the better for the Greek economy. Banks can actually make good business here and the economy as a whole would benefit from that.

Q: Looking back to the economy, the government is trying to present this agreement, reached within the Eurogroup, as a success. At the same time it is present ing, I would say a parallel programme, which is designed to support the weakest or those who were hit hardest during the crisis. Do you see that there is leeway in the budget, so that this programme can be funded?

A: The agreement in the Eurogroup was a success. We were able to agree on a framework, how we look at the need for debt-relief. That’s very positive and the first step has already started. It’s always possible to accommodate the preferences of the government. There were also other countries that went through adjustment programmes, new governments were voted into office, their new preferences were accommodated, but only within the old framework of the programme. I don’t think it would be possible to accommodate new preferences by increasing the agreed budget deficit or decreasing a primary surplus. That would not be acceptable to many euro area countries. That would be outside the agreement reached and agreed with the Greek authorities. But within these agreed parameters, there can be changes.

Q: After all, there is the agreement for the automatic fiscal correction mechanism. So there is absolutely no way to get around the agreement.

A: That’s right. Because that would kick in automatically if the fiscal targets are missed. This is something that gives me confidence that the programme targets will be reached. It will also give confidence to potential investors who don’t like surprises.

Q: Who will have the final say on the activation of the mechanism?

A: I am sure we will look at that together. It will be done in the light of the Eurostat calculation of the deficit within the agreed definition. We always get numbers for the previous year in the second half of April of the following year. As soon as the numbers come out, we will sit together. We are in permanent contact anyway. The institutions and the Greek authorities will talk, it’s not something that the European partners will decide and impose. It will be done together. I think we have reached a good level of cooperation and I am confident that we will manage to do that together.

Q: Do you see a risk of political instability in Greece, given that the fact that the government has only a 153-vote majority (out of 300 deputies) in parliament?

A: I cannot comment on domestic political stability. I've been impressed that on some very difficult decisions in the last few months the majority of 153 in the parliament has been there and made it possible to adopt what was needed to make the programme a success.

Q: Yes, but there is a second review coming in autumn. There are issues I would call "thorny", like the labour reform, which is rather difficult.

A: This is normal in every country. We have had programmes in five countries. The IMF had dozens of programmes the last 50 years. Disbursements are always linked to conditionality. That is the general approach. This means that every quarter there is a review, this is very normal, and the review is a moment to look at progress in the implementation, to look at what was agreed, to look at what we can call prior actions or milestones and whether they have been adopted or not. Of course, there are always some difficult issues. But in the current Greek programme, a lot has been done upfront. The frontloading was quite remarkable, there is no need for additional fiscal measures, that's very positive. I realize that some of the outstanding measures, for example the labour market reform, are difficult, very sensitive. But we had many sensitive reforms before, like pension, tax reform. A lot has already happened. That is why we have already disbursed a lot. With our disbursement this week, we have now disbursed already one–third of the 3-year ESM programme only nine months after it started.

Q: The government is trying to achieve its fiscal goals mainly through higher taxes. And that's something that we know for the past seven years: More taxes and fewer spending cuts. How do you expect the economy to recover in such an overtaxed environment?

A: Economists know that it is better to cut expenditures. For economic development, it is always better to reach a certain budget consolidation goal with expenditure cuts than through tax increases. Experience tells us that in the short run, it is often easier to raise taxes than to cut expenditure. Often governments say this is the only way to do this in the short run. Expenditure cuts are politically not easy to do. But if a government opts for tax increases, it is better to do it through widening the tax base.

Contacts

Cédric Crelo
Head of Communications and Chief Spokesperson
+352 260 962 205
c.crelo@esm.europa.eu

Anabela Reis
Deputy Head of Communications and Deputy Chief Spokesperson
+352 260 962 551
a.reis@esm.europa.eu

Juliana Dahl
Principal Speechwriter and Principal Spokesperson
+352 260 962 654
j.dahl@esm.europa.eu

George Matlock
Senior Financial Spokesperson
+352 260 962 232
g.matlock@esm.europa.eu