

Klaus Regling in interview with de Volkskrant (Netherlands)

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Interviews

ESM

Interview with ESM Managing Director Klaus Regling

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[Editorial introduction to the interview]

The Stability Pact - the budget rules for the euro countries that have been sanctified by the Netherlands - is unworkable. Even worse, the labyrinth of hundreds of pages of legal text built up over the years and explanation of how to implement the laws is the source of deep distrust between EU countries. "Good rules are understandable rules, for politicians and citizens alike. The complexity of the Stability Pact makes that impossible", says Klaus Regling, the boss of the European Stability Mechanism (ESM), the emergency fund for euro countries.

Tomorrow (Saturday), the European ministers of Finance will discuss in Helsinki for the first time in years how the Pact should continue. While the Finnish EU presidency politely asks the ministers whether something might be wrong about the effectiveness of the rules, the European Commission has already drawn its conclusion in a confidential note: the pact leads to frustration, polarization and

should be seriously simplified. Regling (68) shares this opinion: "There are too many rules with too many exceptions and that feeds mutual distrust. It is almost impossible today to understand what are the guiding principles behind the rules."

Volkskrant: What needs to change?

Klaus Regling: The pact should be shorter and simpler, as it was originally intended. More emphasis on reducing the national debt, less on the deficit. Of course, we cannot ignore the 3% limit for the budget deficit that is laid down in the European Treaty. But the countless exceptions we have devised later press for a new, clear rule: it would be useful to link the increase of government spending to economic growth.

There is a rule for the debt: a maximum of 60 percent. Countries which are above that level must step by step reduce their debt. Very clear, why should that change?

Because these steps don't work. It must be more realistic.

You mean softer?

I can't say that now. The debt rule was introduced with all good intentions at the time. But the world we live in today is way more complex. The euro crisis was the biggest financial and economic shock in Europe in 80 years. At that moment increasing government spending to stimulate the economy was the right thing to do. But as a result, the average government debt in the eurozone increased by 30 percent points. We must deal with this in a pragmatic way.

Dutch finance minister Hoekstra and many Dutch citizens say: you have to stick to the rules, not stretch them. As a German, you may have sympathy for that.

Certainly! I wrote the German proposal for the Stability Pact 25 years ago as a civil servant: a simple pact with sanctions. Fines are useful. If you drive too fast on the highway, you also have to pay. At the same time, I want to stress that despite its complexity, the current Pact works better than most people believe. In 2008, the last

year before the crisis, the average deficit in the euro countries was 0.5 percent. Japan and the United States were then at 3 percent. Today, the euro countries have virtually no deficits on average, the US is at 6 percent, Japan at 3 percent. Europe is doing better than the rest of the world. Because the Stability Pact constantly reminds Member States that sanctions are possible.

No euro country has ever been fined despite breaking the rules. There is always an exception to the rule.

The fact that the sanctions have never been imposed does not mean that they are useless. To some extent, they do exactly what they are aiming for: preventing the rules from being violated as much as possible. Its mere existence ensures that the EU performs better than the rest of the world. "

That sounds like political homeopathy: a few molecules of effective substance and everyone is healed.

It works for speeding offenses: mostly you respect the maximum speed limit.

Minister Hoekstra demanded this spring heavier fines for euro sinners: exclude them from all EU subsidies. Do you understand that?

As I said, the current sanctions do work. I see no need to add new fines.

[Editorial context]

Earlier this week, Regling was in the Dutch parliament. Behind closed doors, he discussed the future of the eurozone with parliamentarians from a dozen northern and central European countries. Though his audience - the Dutch parliamentarians foremost - dislike the idea, the ESM boss argued for the establishment of a solidly filled "shock fund" for euro countries who because of external developments, end up in acute financial problems. Ireland for example, as the result of a disastrous Brexit. Hoekstra and Prime Minister Rutte are horrified by it but according to Regling, a shock fund is just as necessary as it is logical for euro countries.

After all, they hardly have any options left to absorb shocks: juggling with the

exchange rate or printing money is no longer there, that's the competence of the ECB nowadays. And the ECB decides for the entire eurozone, which is not always the best recipe for the individual euro countries.

There are several ideas for such a fund, says Regling. It can take the shape of a fund that supports investments that a country that can no longer finance itself. Or a European re-insurance of national unemployment schemes. Or just a "rainy day" fund, a pot of money to counter harsh economic conditions. Such funds can be put up without creating permanent money transfers from richer to poorer countries, the great fear of the northern member states. So a one-off contribution from the Member States instead of an annual contribution.

Volkskrant: How big should that pot be?

Klaus Regling: I think about €100 to 200 billion. This does not necessarily have to be pre-financed by the Member States; the ESM has money available. Countries receive financial support and pay it back the in the next 5 to 7 years. So it's a loan, not a transfer."

Netherlands, Germany, Finland, Austria fear to pay for southern countries which do not bring their budget at order. Do you understand that fear?

It is an unjustified fear. Moreover, it is short-sighted: it is not always the southern countries where the problems are. Dutch citizens paid much more for the rescue of Dutch banks than the Italian taxpayers for their banks. The same goes for the Germans, who paid an extremely high bill: €60 billion in tax money disappeared in German banks.

Could you convince the parliamentarians of the need for a shock fund?

Some agreed with me but many did not. Anyway, nine years ago the establishment of the ESM as an emergency fund was also highly controversial in the Member States. Now most are convinced that it was a good decision and all ministers agree to a wider mandate for the ESM. The rescue fund prevented the entire euro zone from falling apart, without costing the taxpayer a single cent. The loans to Greece, Portugal, Cyprus, Ireland and Spain are so far all being paid back with interest. A

shock fund is needed to make the eurozone less vulnerable to new crises. And it can prevent small problems from becoming big ones.

In particular, under Dutch pressure, the idea of a shock fund has been reduced to an "instrument" to strengthen competitiveness and reforms. Future ECB president Lagarde recently sneered that this instrument is too small to have an impact but fortunately also too small to harm the eurozone. So, a waste of time?

The proposed new "instrument" is a compromise that has nothing to do with absorbing financial and economic shocks. It adds to what can already be done with the regular EU budget. A real shock fund would have filled the gap that exists in our currency union.

Does the new Italian government diminish the risks of euro-wide misery originating that country?

The risks have certainly been reduced but the economic situation in Italy is not suddenly different. However, Italy is not the new Greece. Italy has never lost access to the financial markets but is struggling with high government debt of 130 percent. That debt is not falling because economic growth in Italy has been very weak, half the EU average, for the last 25 years. And that again is the result of a lack of reforms. So Rome knows what it has to do.

If investors would lose confidence in Italy, is the ESM big enough to save it?

I don't expect this will ever be necessary. But even in such a very hypothetical scenario, the ESM still has 400 billion euros available. This allows it to take over Italy's financing needs for two years. This buffer can be combined with the purchase of government bonds by the ECB. So money is not the problem. Nobody has to fear that the ESM is too small for Italy.

You started in 2010 with a handful of employees. There are now around 190 and another 30-40 will be added soon. Meanwhile all "clients" of the emergency fund are back on their own feet. The ESM should shrink. Is this

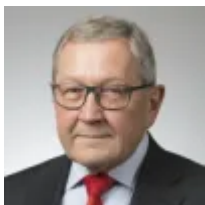
"mission creep", the insidious growth of EU agencies?

Our growth has nothing to do with mission creep. Firstly, we have lent roughly €300 billion. For this, the ESM issues bonds which requires staff. The ESM borrows around €30-40 billion a year on the international financial markets to refinance these outstanding loans, about the same as the Netherlands. In addition, our customers must pay their interest and repayments on time, people are also needed for this. And now the Member States want to give us more tasks: a more central role in future rescue operations and we will be the backstop for the European fund for banks in resolution."

What lessons do you learn from the Greek crisis?

Mistakes happen in crisis management. We should have started debt relief earlier for Greece, but initially we didn't have the instruments for that. We underestimated how much adjustment was needed. But I totally disagree with critics who say there has been too much austerity in Greece. Greek incomes had risen 20-25 percent faster in the decade of the euro than the productivity. That was untenable and had to be corrected: very painful but inevitable.

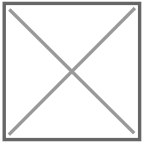
Author



[Klaus Regling](#)

Managing Director (2012 - 2022)

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