

Interview with Klaus Regling, Managing Director, ESM

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Greece is not done with reforms. More assistance might help

We can see that situation in case of sovereign debt crisis is quite stable at the moment comparing with situation two years ago. But there are some issues. Debt of most countries in euro area is still rising, Greece wants to leave bailout program sooner and France and Italy announced higher deficits. May we expect new escalation of sovereign debt crisis in monetary union?

We do have some problems in Europe but they are not all related to the sovereign debt crisis. We have come a long way in resolving the crisis. The EFSF and the ESM played an important role. It is crucial that countries that lost market access have implemented and continue to implement the reforms, which will bring them back on track. We know that three of five countries which received help from the ESM and EFSF have now exited the programs and they are doing well. I do not say that everything is perfect. There are still two countries in programmes – Greece and Cyprus. But both countries are continuing on the reform path.

European leaders are very cautious about sooner exit of Greece from bailout program. Athens plans to leave it at the beginning of next year instead of first quarter 2016. Is Greece ready to do it?

It is understandable that Greece wants to follow former programme countries like Ireland and Portugal and leave the programme. Obviously it is more pleasant for a government to not be in a programme anymore. But the reality is that the reform agenda in Greece is not completed yet. This is a fact that everybody has to take into account when the decision is taken how to proceed in Greece after the end of the year.

Can you compare the situation in Greece with countries that already exited the bailout program?

Greece has made tremendous progress, especially in terms of fiscal consolidation. But Greece is not yet in the same situation of Ireland and Spain when they exited their programmes at the end of 2013. Now we have to see what the Greek government will decide to do. There are still structural reforms to implement where the assistance from Europe and the IMF might be useful. Moreover we still do not know how much money will be needed to finance the budget of the country in 2015. We don't know how much money Greece will be able to raise on the markets. All these things are not clear for the moment so it is impossible for me to say what will happen.

The second issue are budget deficits of France and Italy. They are significantly higher in comparison with plans revealed in April. For example France will not meet the criteria of the fiscal pact by 2017. Is the euro area ready to ease fiscal consolidation and focus more on growth?

There is a long debate behind this question. It is the debate about fiscal consolidation and structural reforms. The governments in France and Italy announced that they will undertake the reforms. On the fiscal side, the rules of the fiscal compact are quite clear. But there is also some flexibility that takes into account the current economic situation in the country. So under certain specific circumstances the target can be postponed. This issue will be analysed by the European Commission. The Commission will tell us soon what it thinks about these questions in both countries.

And what is your personal opinion in this issue?

I think that the rules must be applied. And that includes all the flexibility that the rules provide.

By the way, you are more than 4 years the head of EFSF and ESM. You build it up as an institution that helps calm down debt crisis. What were the biggest surprises for you during this period of time?

These four years passed very quickly and many things happened. And of course, there were many, many surprises.

Try to mention the biggest one.

When I was appointed to build up the EFSF and ESM I did not expect that we would have to support so many countries. The crisis grew larger than I thought. The initial idea was that we would build up the EFSF but there would not be any need to activate it. When I started with the EFSF there was nothing: no office, no telephone number, no e-mail address. After a few weeks I was able to hire a few people who worked with me. We had an office and started to build up an institution. But nevertheless: when we issued for the first time a bond in January 2011 to provide a loan to Ireland, we were only 8 staff at the EFSF. It then became unavoidable to grow substantially. By now the EFSF and the ESM have provided loans for €232 billion to five countries, that is three times more than the volume of loans that the International Monetary Fund has provided globally in the same time.

Were there any political issues that surprised you?

I was surprised that the gap in views between northern European countries and southern European countries grew so large. I think this is improving now. Some of the countries in the periphery were asked to go through very painful adjustment and in order to help them to adjust they were assisted with a huge amount of money in EFSF or ESM loans. The North was concerned that money of the taxpayers would be transferred. But if you looked at the situation closely there were big misunderstandings on both sides. The reality is that the programme countries benefitted from strong solidarity because of our very low interest rates and our very long maturities. In the case of Greece this is worth € 8.6 billion only for 2013 or 4.6% of GDP. But the reality is also that no taxpayer money is lost because we go to the market and raise the money there for our loans. So there were a lot of misperceptions on both sides.

Slovakia did not enjoy the idea to support richer countries like Greece. The concept of solidarity seemed strange for us because we were poorer than Greece. How did you feel about position of Slovakia?

It was not only Slovakia. There were several other countries with a GDP per capita which was smaller compared to Ireland or Spain. Also these other countries have complained about that and that is understandable. But I think that it has become clear that what we are doing is in the interest of the whole euro area including Slovakia and other countries with a lower GDP per capita level. After all, we provide an insurance for every member that the ESM will be available should a country get into a severe crisis and no longer be able to finance itself on the market. It is a fact that things may go wrong for a country. We all hope that this does not happen. But economic history shows that crises do happen from time to time.

Slovakia has also representatives in ESM. What are your work experiences with them?

State secretary Vasil Hudák is on the ESM Board of Directors and your minister of finance Peter Kažimír is member of the ESM Board of Governors. Our relations are excellent, we work together in confidence and I personally treasure Peter Kažimír's experience. I just had a long and very stimulating

discussion with him. Slovakia is a very respected member of the euro area and it contributes to making the EFSF and ESM credible.

But many experts see problems in Slovakia. At least in the way how we are reducing our budget deficit. It is not made systematically and on sustainable path.

Let's keep things in perspective. Slovakia is better than many other states in the euro area in terms of growth and reforms. There is also the intention to significantly improve the structural balance next year. Generally, I would like to say that there are the so-called "country specific recommendations" for every country in the EU, including for Germany for instance. Not only for countries in problems. But what we can see is an implementation gap in the larger euro area economies that are not in a programme and therefore have no economic policy conditions with which they have to comply.

What does the implementation gap means in practice?

Five countries in bailout programme – Greece, Ireland, Spain, Portugal and Cyprus are the top reformers not only in the euro area, but also in the OECD. This proves that conditionality really works. On the other hand we see countries like France, Italy but also Germany with a lack of structural reforms in comparison with countries in a programme. Unfortunately this is true for most of the countries which are not under a programme with conditionality.

Do you see any way how to reduce this gap? How it can be done?

From the programme countries we see that conditionality works. Drawing from that conclusion one way to reduce the implementation gap could be to create a sort of conditionality for countries not in a programme. For example, there was the proposal for a fiscal capacity in the euro area a few years ago. The money in this pot could be used to reward countries to undertake politically difficult reforms. I think this is a promising idea and my impression is that some leaders in Europe are starting to think about reviving this idea again.

Maybe there is lack of reforms on the national level, but we will see starting of huge project in euro area. I mean Banking union. Is it really step forward?

I definitely think that this is an important step forward. We need it. For example there is the Single Supervisory Mechanism that is now about to start its work. We know that all the bigger banking groups in Europe are operating cross borders. This makes it very difficult for national authorities to supervise them. Moreover we see an increasing fragmentation of financial markets along national borders during the crisis. This has very negative effects because companies in some countries have to pay much higher interest rates compared to their competitors in another country although the creditworthiness of the company may be very similar. Banking union is designed to eliminate these problems and to create a level playing field in Europe for borrowers, investors and consumers.

Banking union will start at the beginning of next month. But it will take few years to finish it. Is ESM ready to help banks in this period of transition?

Europe has come a long way in the case of banking union. We achieved something that seemed to be impossible a few years ago. Banking Union is one of several examples that the crisis triggered positive development. We have the Single Supervisory Mechanism, we are currently building up the Single Resolution Fund. And there is one element that involves the ESM. The ESM will be available as a last line of defence to recapitalize banks directly under very specific circumstances. But there are many steps before that. One important example is the bail-in of bank creditors. Also direct bank recapitalization is possible via a loan to governments as we did in Spain.

Do you expect that some banks will need direct recapitalization from the ESM?

I do not expect that we will need that.

There is also another interesting information about ESM. It plans to provide not only bailout loans, but also loans to support economic growth, to use money in the ESM. Is it true?

For the time being this is just an idea. . It would theoretically be possible that the ESM contributes to the €300 billion investment package that the new Commission President Jean-Claude Juncker has announced. But this would only be possible if the ESM Treaty was changed. A change of the ESM Treaty requires ratification by all the 18 governments and national parliaments of the euro area Member States. And this is very unlikely to happen.

Let's go back to banking union. It looks like it will be difficult, if not impossible, to complete it. There is lack of will among politicians to make deal about the single deposit insurance fund in Europe.

At the moment it is too difficult to achieve it. It is difficult to implement, because we have such different positions in different EU Member States. In some countries we already have special funds, where the money is already accumulated. In other states there is no money at all. So to merge these systems is extremely complicated.

Do you think that there will be full scale banking union one day?

I think one day yes. But I do not know when exactly and how long it will take.

So you are optimistic.

I am always optimistic about Europe. That helps me to do my job. Let me also add: my optimism about Europe often turned out to be realistic. The crisis and the euro area's reaction to it showed that we were able to achieve a lot more than many of us believed was possible. I never doubted the political determination of the euro area governments not only to maintain the euro area but to make it more robust and sustainable.