Interview with Klaus Regling, Managing Director, ESM

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Wirtschaftswoche: The majority of British people have voted against remaining in the EU. What are the implications of Brexit for the euro?

Klaus Regling: Let us see if Brexit really happens. We are only at the beginning of a very long process, much can still happen. The vote in the UK was dominated by emotions. Perhaps the last word has not yet been said on this question.

One way or the other – Europe is facing a prolonged period of uncertainty. What does that mean for the economy?

It would be helpful to have clarity quickly on what will happen in the next months at the political level. The fall of the pound to its lowest level in 31 years causes disruptions for exports in all of Europe, also in the euro area. The movements on stock markets that we see around the world as a consequence of the referendum, could of course have consequences for the currency union. For the time being, these consequences are contained. But a country like Ireland, with half of its exports going the UK, is strongly impacted.

Investors are looking with scepticism again at countries at the eurozone's periphery like Spain and Portugal. Interest rates on government bonds have risen after the Brexit referendum. Are you worried about this?

The only country I am worried about is Portugal, independently of Brexit. The government there is rolling back the reforms. As the European institutions noted after their recent country surveillance mission, Portugal is becoming less competitive again as a result of this. The lack of competitiveness was one important reason for the crisis in Portugal. Now Portuguese politicians have raised the minimum wage and salaries in the public sector again and they have shortened the working hours again. There could also be new budgetary risks if the government solves the problems in the banking sector with state aid. We have to pay a lot of attention to what happens.

Commission President Jean-Claude Juncker is asking as a result of the Brexit referendum that the euro should become, as quickly as possible, the only currency in the EU.

I think that almost all countries will eventually join the euro if the British really leave the EU. The pace will be very different from country to country because the problems and the preferences are different. The concept of a two-speed-Europe will become much more durable also for currencies if the British remain in the EU. The UK would then form an outer circle together with Denmark, Sweden and other countries while the euro area would consist of strongly integrated countries.

Doesn't Juncker overlook the fact that countries have to comply with accession criteria before the can the join the euro?

The accession criteria are in place. At the moment, none of the non-euro countries fulfils the accession criteria. It will take time before they will.

The votes in the Brexit referendum were barely counted when the desire for more integration was expressed in Brussels. Can that be the solution?

More Europe cannot be the general answer. Even before the UK referendum, many citizens in a lot of European countries did not want to have "more Europe". This is linked to a counter-movement to globalisation that exists not only on our continent but throughout the world. We can clearly see that in the US election campaign, but this development has also been evident in Switzerland for a long time. The EU is a real template for globalisation, for cross-border cooperation. Therefor we have to take all movements against globalisation seriously and we have to deal with them.

Do you understand the fears against globalisation as an economist?

As an economist, it is difficult for me to understand these reservations because we are convinced that cross-border cooperation and trade raise the living standards of people overall. The overwhelming majority of people profit from that, economic history clearly demonstrates that. Apparently the elites have not been able to explain these advantages. Also, we economists know that free trade generally also produces losers. Perhaps we have neglected to cater sufficiently for these losers.

The euro is an unfinished construct. How important is it to complete this construct now?

In the past years, we have already strengthened the euro area significantly in response to the euro crisis. Institutions such as the rescue fund ESM and the bank resolution fund [the Single Resolution Fund] have been created, the member states have agreed on banking union. New rules strengthen the coordination of economic policy. One should remember all that when asking the question which changes are necessary for an improved functioning of the currency union. I don't see so many areas where further work is required. Also, if one is aiming for further deepening in certain areas, some competencies could be returned to member states. The package simply has to be balanced.

Where do you see a need for further action?

One of my most important tasks is to be in touch with investors so that the ESM can sell its bonds throughout the world. In my conversations with them, they always ask about two things: they want banking union to be complemented by a joint deposit insurance scheme and they want a fiscal capacity for the currency union, in other words its own budgetary resources. Both are being discussed in Europe, but it is highly controversial and I am sure both will not be implemented overnight.

Both points are being opposed by the German government – the banking union, because a joint deposit insurance is seen as carrying too high a risk.

I understand the German reservations about a deposit insurance scheme well because the starting points in the euro countries are very different. In Germany the system differs according to the bank sector, some have large funds of accumulated capital. In other euro countries, there is no deposit insurance based on saved capital, only on guarantees. These diverse systems cannot just be merged within a short time, first all euro countries have to create common conditions. Also, some countries are still confronting legacy burdens of their banks that they first need to reduce. That will probably take years.

Berlin is against budgetary resources for the eurozone because it fears this will result in a big redistribution towards the South. Is this fear justified?

These proposals don't come from me but from big investors with whom I talk. They expect that something happens on both points. According to them, there is a lack of an instrument that can be used in a targeted way in case of shocks hitting only certain countries. In this context, one can think of concepts that do not lead to permanent transfers and that do not lead to a mutualisation of debt. This would improve the functioning of the currency union but I don't expect such a proposal in the coming months. But it is interesting to note that comparable instruments exist already in the US. In times of crisis, the American states can tap "rainy day funds" but they have to repay the money the draw from them at a later stage.

You have been working for many years at the European level. Have you ever seen the EU in such a disastrous condition?

In the current situation, it certainly helps if one has been around for a long time and one has experience. Europe has seen a lot of crises. It started when the European Defense Community did not materialise, although it had been firmly agreed in 1952. In the mid-seventies, everybody talked about euro-sclerosis. Later we had the lost referenda on the European constitution. In all crises, the participants intuitively felt that the situation was horrible. That is the very characteristic of a crisis: when you are in its midst, it is never clear if, how and when one will be able to overcome it. During the euro crisis, many people predicted the end of our currency. Well, the euro still exists. Now again, after the refugee crisis and the decision on Brexit, many say that the EU is finished. I say that what we are currently witnessing is comparable to what we had to confront in the past. I am confident that we will master this crisis as well.