Interview with Klaus Regling, Managing Director, ESM

Published in *Il Sole 24 Ore* (Italy), 14/09/2014

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The EFSF/ESM have a joint maximum lending capacity of about 700 bn euro. What has been done so far? And what is there to come?

In 3,5 years of activity, EFSF/ESM supported 5 countries with a total disbursement of 232 bn euro: EFSF supported Ireland (17.7 bn), Portugal (26 bn) and Greece (141.8 bn), the ESM supported Cyprus (5.4 bn) and Spain (41.3). The interest rate applied was the same for all, basically to our funding cost, which is now on average around 1.5%. We can raise funds cheaply as we have a high rating (AAA, Aa1). The average maturities of the programmes vary from country to country: the shortest was Spain's (a programme for the financial sector), which lasts on average 12,5 years, the longest is Greece's which is up to an average of 32 years. Greece is the most difficult case and by far the biggest loan (the last repayment by Greece is set for 2054).

The programmes for Ireland, Portugal and Spain have been concluded. We still have to disburse 3.6 bn for Cyprus out of a total of 9 bn, and Greece's programme will conclude at the end of this year with a 1.8 bn disbursement still available for disbursement if conditions are met.

Did EFSF and ESM incur in any losses up to now? Is Italy wasting or risking taxpayers' money by paying € 14 bn for the ESM in paid-in capital and with its 37.9 bn guarantees on EFSF bonds?

We never made any losses. We don't make large profits but we don't lose money either: we lend money that is paid back by countries under an EFSF or ESM programme. Each programme has conditionality attached to it, according to the individual situation of each country. Conditionality means that a country that receives our loans signs a MoU in which it agrees to implement structural reforms and fiscal consolidation over the programme duration, typically three years. This means that each disbursement is linked to specific actions. The money is only disbursed after the Troika (Commission, ECB, IMF) has verified the implementation of what was agreed.

The impact of our activities on creditor countries' public finances is limited. The guarantees to the EFSF and the paid-in capital of the ESM do not increase the deficit: paid-in capital is not used for lending – it is not money spent on loans, it is an asset that is at the ESM being remunerated through investment in high quality and liquid securities. The EFSF bonds, on the other hand, are recorded as debt of the member states according to their share in the EFSF.

It is a kind of "reverse privatisation": no impact on deficit but only on debt. By issuing EFSF bonds we use guarantees which have an impact on debt temporarily. When countries under Efsf programme pay back the loan, we repay our bonds when they are due, and the public debt of our guarantors decreases. On the other side of this limited risk there is an indirect benefit, which is a huge benefit, from our activities for the Eurozone.

What kind of direct benefits are you referring to?

We would live now in a very different world and a very different Europe had the EFSF and the ESM not intervened with aid programmes for countries facing a crisis. Remember: some countries lost access to the market and ran the risk of insolvency. There was a real threat that some nations would have to leave the currency union in a disorderly fashion. If that had happened, interest rates and spreads would not have fallen as far as they have, we would not be where we are now without our programmes. Europe could be a different place today.

Moreover the countries under our programme will have a better economic performance in the future compared to others. In some countries growth is already accelerating. Why? They implemented the reforms of the MoU and these reforms will bear their fruits. They went through tough, painful fiscal adjustments. Programme countries had to cut salaries and pensions, their economic reforms increased flexibility and competitiveness. It works. I am very confident about their future. These countries are now amongst the best reformers in the OECD area. Our strategy of providing temporary loans at very low interest rates against conditionality works. Decades of IMF programmes support my confidence. For example, Indonesia, Turkey and Brazil entered IMF programmes: they went through hard times as it took a few years for them to reform but their economic performance improved dramatically afterwards.

Italy did not ask for aid, did not enter a programme, did not sign a MoU. And indeed Italy is not one of the best reformers in Europe, actually we are late. Some steps have been made but at a slow speed and Italy is back into recession: what is your assessment of Renzi's reform programme?

Prime Minister Renzi has said he is in favour of reforms and has portrayed himself as more pro-reform than other recent Italian political leaders. And his impressive result at the European elections shows that the Italian electorate supports his pro-reform stance. He has set a time of 1.000 days to carry out structural reforms and I think this is the right way to do it: reforms cannot be done all at the same time, all immediately. In the past Italy has not done all the necessary reforms and this is reflected in its slow productivity growth. Prime Minister Renzi is addressing the problems by setting a programme. Now it is crucial that his announcements are followed up by action. Implementation is now the key.

Wouldn't it be easier and quicker for Italy to sign a programme with the ESM to impose itself a rigid timetable for structural reforms and fiscal consolidation?

Italy never lost market access. The loss of market access or the risk of being cut off the markets led the governments in programme countries to ask for our intervention. Italy is a rich economy and it has the third largest GDP in the euro area. Italy does not need to enter a programme.

Italy has a huge public debt and it is paying very high interest rates for servicing it (€ 84 bn per year is the last figure reported by the Italian Economy minister Padoan). These payments are draining money that should be used for investments, for growth: there is a debate in Italy on the convenience for an orderly debt restructuring like Greece has done through a EFSF/ESM programme. This would allow us to spread interest payments on a longer time span, over 50 years…

The situation in Italy cannot be compared to Greece. Italy does not have Greece's problems. I want to emphasize this: Italy should not restructure its public debt, it does not need to do it. Italy can service its debt with growth. This debate on debt restructuring is very academic. I agree that more should be done to increase investments: investment dropped by 20% in the euro area with the crisis and it has not recovered. But there are plans to enhance investment. The plan of the new Commission President Jean-Claude Juncker for a new investment package of €300 bn goes in that direction. But at the same time countries on a national level must implement structural reforms to make their economies more attractive for private investments. We need more private-public-partnership projects. Also the EIB may be able to do more and the EU budget could be better used to support investment.

Can the ESM do more in this direction too? Out of a total maximum lending capacity €700bn , the EFSF and the ESM used less than € 250 bn up to now. Couldn't the rest be used for investments, for growth, for guarantees?

The ESM is a crisis mechanism to be used in a crisis situation, when an emergency occurs. At the moment ESM interventions are not needed, the situation in the euro area has improved and the crisis is coming to an end. But history teaches us that crisis do occur. And new crisis will come one day. In that sense, the ESM is like the IMF, which has money in excess of what it's lending. An important feature of our task is to reassure the markets that there is a solution should a crisis reoccur.

Will the ESM change its mission entering a new role in the European Banking Union?

The ESM has several roles in the banking union: First, we can provide a loan to a country which can be used to recapitalise and restructure the banking sector. This is what the ESM did in Spain. Secondly, we can provide loans in the context of a macro-economic adjustment programme. A part of our lending is used by the governments to solve banking problems. To varying degrees this was done in Greece, Ireland, Cyprus and Portugal.

Thirdly we prepare to be ready to recapitalize banks directly. In this case, the ESM would recapitalize a viable bank that faces big problems. But this will be a new instrument for the ESM. The euro area Member States are expected to take the final decision to create this instrument shortly. But this would be an intervention of the last resort. It would be the last line of defence in the unlikely case that all other steps to recapitalize the bank have been exhausted.