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Hearing with Members of the Economic and Monetary Affairs Committee (ECON) of the European Parliament on the work of the Troika

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(Please check against delivery)

Introduction

- Thank you for the invitation to explain my views on the topic.
- I welcome the debate because I think transparency and discussion are essential ingredients for lively democracies.

The Troika's approach

- Before talking on substance I would like to clarify my position. The EFSF and the ESM are not part of the Troika and as the ESM's Managing Director, I don't represent the Troika. But the Troika operates under the legal framework of the EFSF and the ESM. It is in charge of the programme – i.e. the economic and financial analysis and policy conditionality – linked to the provision of financial assistance.
- The EFSF and the ESM are interested in the success of the adjustment programmes also because that is the best guarantee to be repaid.
- It is not my role to defend the Troika. But I would like to stress that I support, overall, its economic approach. Some euro area members and the currency union as a whole were in an existential crisis. When the crisis erupted, we had neither appropriate tools to assess what had to be done in these countries nor a specific institutional setting to cope with unprecedented and unforeseen circumstances. In such a situation, the Troika approach – the cooperation between the Commission, the ECB and the IMF – was established.
- For over a decade I worked at the IMF and therefore I am familiar with the programme design used by the IMF for many decades. This programme design served as a model for the programmes of the euro area members under assistance.
- From that time, I know that granting temporary rescue loans to countries that have lost market access against strict conditionality works well if there is national ownership and full implementation.
- In the following minutes I would like to concentrate on three topics:

1. The economic adjustment in the programme countries
2. Democratic legitimacy of the programme decision and implementation
3. The chances for programme countries to return to a sound and sustainable economic, budgetary and financial situation

The economic adjustment in the programme countries

Sceptics of the current approach claim that the situation in the programme countries would be very different if only another approach had been chosen, if less austerity had been applied.

- I believe this criticism misses the point.
- The reality is that Greece, Ireland, Portugal and Cyprus faced two options when they took the decision to apply for an EFSF or ESM programme:
- The option they chose was to ask for the solidarity of their euro partners: temporary loans at favourable interest rates and with very long maturities. In that situation these loans were the only source of financing for these countries because they had lost all access to the financial markets.
- Crucially this option allowed the programme countries to remain a member of the euro area. Polls show that this is what the overwhelming majority of the population in these countries want.
- In exchange for the rescue loans, the countries had to agree on country-specific macro-economic reforms and fiscal consolidation in order to put their economies back on a sound footing, regain investor confidence, and eventually be able to finance themselves on the markets.
- For this to happen, painful economic adjustment was unavoidable. This adjustment put a heavy burden on many people. They saw their salaries or pensions reduced, public expenditure and social services cut, while unemployment rose.
- Understandably, this temporary hardship often results in anger and frustration in the population. These feelings make people receptive to suggestions that another somehow painless way out of the crisis would have been available.
- But this other option is an illusion. The alternative to the current policies in the programme countries would not have been painless, rather the contrary.
- In essence the EFSF and ESM loans allow the programme countries to buy time to spread the necessary adjustment over a longer period.
- The alternative to the current policies would have been a disorderly default of the country, the collapse of the economy and the exit from monetary union. In my view that would have led to more hardship.
- Without our loans, the adjustment would have had to happen overnight. It would have been brutal: Governments would have had to reduce expenditures to the level of revenue overnight.

- History shows that countries that go down that path not only inflict serious hardship upon their population, but also shut themselves out of the financial markets for long periods of time with negative consequences for economic developments.

Democratic legitimacy

- Some claim that the rescue programmes impose economic, fiscal and social policies upon the programme countries without political control, accountability, transparency and democratic legitimacy.
- I strongly disagree with this view for a number of reasons.
- The Troika gives advice. It does not take final political decisions. The political decisions are taken by democratically elected euro area governments.
- The Memorandum of Understanding, the MoU, that defines the conditionality under which the loans are granted is discussed and decided in the group of euro finance ministers, all are part of elected governments.
- In most programme countries, the national parliaments voted on the MoU and again on most of the individual steps that needed to be taken subsequently. In some countries like Portugal and Ireland even opposition parties at the time, which are today in government, committed to the assistance programme.
- All EFSF and ESM programmes were decided unanimously by all the euro area finance ministers. In about a third of the euro area countries the finance minister could agree to the programme only once his or her national parliament had given authority to do so.
- The political and democratic control via national euro area governments and parliaments, and not the European Parliament, reflects the fact that our financing of the programmes in financial markets is backed by national budgets of euro area Member States, not from the EU.
- Member States opted for an intergovernmental approach to resolve the crisis. The creation of the temporary EFSF in 2010 and the permanent ESM in 2012 as the first euro area institution outside of the EU Treaty is the direct result of that choice. This could be reconsidered in the future.

The Strategy

- I would like to finish by pointing to the results of the programmes.
- I am not minimizing the difficulties that the countries are facing. Unemployment is unacceptably high, especially among young people.
- But there are clear signs that the strategy is working.
- Even a few months ago only few people would have believed that out of the five countries that were under an EFSF or ESM programme, Ireland and Spain would be able have a clean exit. Both countries were very successful in issuing government bonds last week.

- But also in the three remaining countries under assistance – Portugal, Cyprus and Greece – cautious optimism is warranted.
- Last week Portugal successfully issued a 5-year bond. The programme in Cyprus is very much on track. Even in Greece, where the starting point was undeniably by far the most difficult one, is making progress. The country had a deficit of more than 15% in 2009. This year the deficit is estimated to be down to around 2%.
- Unemployment in the programme countries stopped rising further and is starting to decline.
- It is too early to claim victory and reform efforts must be continued.
- But I think that the accomplished progress should be acknowledged and the national reform efforts in the countries should be applauded.
- National efforts, together with better economic policy coordination at European level, the actions of the ECB, the creation of the EFSF and the ESM and the progress accomplished in building a Banking Union are making the euro area much more resilient against a potential future crisis.