European Stability Mechanism

# Interview with Klaus Regling, Managing Director, ESM
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**Could you explain why Greece remains the only eurozone country still in an adjustment program? Do you understand why we had to reach the brink of collapse before an agreement was reached?**

"This is a very good question. Many people ask me about this and not only from Greece. I believe there are three reasons. First, when we got into the eurocrisis in 2009 – 2010, Greece had the most serious problems. When you look at the fiscal deficit, it was higher in Greece than in Ireland and Portugal. When you look at the trade and current account deficit, it was the highest compared to GDP. The loss in competitiveness was the most serious. The second reason is that the Greek administration is sometimes weaker than we thought. What needed to be fixed took longer because the implementation capacity was weaker. The third reason was, of course, what happened earlier this year. After the January elections, the government of Prime Minister Tsipras changed directions, did not continue the reforms, even reversed some of them. That was a relapse because you remember that in 2014, growth had reappeared, unemployment began to fall and the government was able to issue bonds again. These first signs of success disappeared in the first half of this year but I have no doubt that Greece can now go back to that situation."

**Would you say that the economic projections included in the previous two MoUs were over-optimistic? Can we be sure that this time they will be avoided?**

"Certainly, with the benefit of hindsight, we know that some of the projections back in 2010 were over-optimistic. I think that in the beginning the magnitude of the problems was underestimated. We also did not have experience dealing with a country facing so many misalignments. However, this happened, we cannot change it, and we have to live with it. Now the forecasts are more realistic. We are trying to learn but also the problems Greece is facing today are much smaller compared to 2010. A lot of adjustment has actually already happened even though there are still many things to do."

**Would you say there is real political will from the Tsipras government to reform Greece? I insist on this because the Prime Minister and some of his ministers keep saying every so often that the MoU is not what they wanted but it was imposed on them… In your opinion, is there Greek ownership of the program?**

"Some of the statements we sometimes hear are not so encouraging. But in general I take the view that there was a second election and the program presented to the voters by Prime Minister Tsipras and his team was very clear and he got the majority for that. The mandate was very clear and 75% of the Greek people want the country to stay in the euro area. This is a big difference compared to January – February this year."

**As we are approaching the difficult reform of the pension system, it looks like the Greek government is starting to feel some arrhythmias. Would you say that the social cost of new pension cuts is too high and could bring back political instability in Greece?**

"I am not an expert on pension reform but I know that pension reforms have been difficult in every country in Europe for obvious reasons: it means that old rights in which people believed are changed.

It is going to be difficult for Greece, too, but this is an issue that has to be tackled. The Greek pension system is among the most expensive systems in the EU in terms of GDP. This is out of line with the size of the economy and the standards of living. But there are also other elements, such as early retirement, which create problems for the labor market."

**Are you certain that the IMF will participate in the Greek program? There is a sense that this may not be so easy and the Greek government has recently appeared critical of the IMF's role...**

"My assumption is that the IMF will participate. The conditions are the conclusion of the first review, more information about pension reform, some specification of the budget orientations and some kind of agreement on additional debt relief. However, I am a bit surprised about the uncertainty expressed by the Greek side because the agreement of the Heads of State and Government last July and the decision of last August's Eurogroup very clearly mention that the IMF should be part of the program. The ESM Treaty also says that the IMF should contribute to an ESM program whenever possible. We are talking about an economic adjustment program and therefore IMF participation is possible. This is what the ESM Treaty says which, by the way, was ratified by the Greek Parliament and Greece is not only a recipient of ESM money but also a shareholder. The language in the ESM Treaty is very clear and I am confident the IMF will come on board."

**If the Fund does participate, how will this happen and with how much money? If it decides to withdraw, would the program run aground or do alternative scenarios exist?**

"I think that the IMF's financial contribution is likely to be small but this is not the main issue. There has to be a financial contribution because the IMF, according to the ESM Treaty and to the agreement in the July Summit, should be part of the program also financially. It will not be like in 2010 when the IMF put in one third of the money. It is not my scenario that the IMF will not participate because, even if you put aside the July agreements, some member states which have to obtain the approval of their parliaments for every tranche of the program, know the ESM Treaty and the understandings reached. If the IMF decides not to participate it could be a big problem. But it is not my scenario."

**You know better than anyone else the issue concerning Greek debt sustainability. It is also an issue of disagreement between the Europeans and the IMF, concerning the methodology used. Why do you believe that the ESM approach is better?**

"I think more recently there has been a convergence between our analysis and the IMF's. The ESM programs have created something new. When the IMF alone steps in after a country loses market access, it is a situation where only the IMF is available as a lender of last resort. In Europe we have the ESM and we provide much more money than the IMF could do, with much better terms: longer maturities and much lower interest rates. This means that debt sustainability can be achieved even when the debt stock is very high. Initially, this has not happened in countries outside Europe. The actual annual debt service ratios become more important and they are small because of the conditions the ESM offers. We know that the actual annual debt payments for Greece over the next eight years are very small. There is no excessive debt burden for these years. After these years, it goes up because the interest deferral comes to an end."

**What options are on the table concerning debt relief? Would it be a short-term or a medium-term solution?**

"I think it is more a medium-term issue. There will be no nominal haircut and the Greek government understands that, I believe. We will try to soften the debt profile. We all want to make Greece attractive to investment. We know that when debt is unsustainable, investors are reluctant to go into a country. If we manage to extend a bit longer the period in which the debt repayments are already low, then I think we will create incentives for foreign investment, not only financial investment but also investment for the real economy which has a longer-term time horizon."

**Should there be some extra conditionality for debt relief after the end of the program in 2018?**

"I am sure that this will be discussed because we are talking about very long timeframes. At the same time it is important to realize that Greece as an EU and a euro area member state is already subject to a number of surveillance frameworks such as the Stability and Growth Pact or the Excessive Imbalance Procedure. They should be respected in any case."

**How important is the formation of the new Privatizations Fund in order for the program to work?**

"This is something very important, for two reasons. One, politically it is important. It was negotiated at the top level at the end of the July summit and it is crucial to do it in the agreed timeframe. Otherwise, credibility will suffer. Secondly, privatizations can help the economy become more efficient. We are not talking about privatizations at any cost or about fire sales. There has been so much financing from the ESM that there is no need for fire sales. There are certain public activities that could be run better by private investors or investors from the outside. I am thinking of the Piraeus port and this is a good example of what is possible."

**Recently, the third recapitalization of the Greek banking sector was finalized. However, it looks like a lot of public money used in previous recapitalizations was lost. Are you satisfied by the way the last recap took place?**

"It seems to me that now the Greek banking sector is becoming much healthier. But it is unfortunate that this is already the third round of the recapitalization of Greek banks. One can argue that the Greek government lost money but also many private investors lost money. It was good that we got the interest of private investors even after the previous ones lost money."

**Do you think that Greece has a real chance to access the markets by the end of 2016?**

"Some partial refinancing from the markets by the end of 2016 could take place. But by that time there will not be a proper exit from the ESM program which runs until 2018. Greece's progressive return to the market requires of course full implementation of the program so that credibility is restored. That would be very positive because it is always good for program countries to test the markets early and not to wait until the program ends, by when full market financing is needed again."

**Could you say, with a clear Yes or No, that Grexit is off the table or does it stay in the background?**

"The monetary union was designed in a way that no exit of any country was anticipated. Therefore, there is no framework for that. Greece has agreed to implement reforms which are necessary so that its partners can provide the financing needed and Greece can return to a sustainable economic situation. But ultimately the possibility is always there, if commitments as a member of monetary union are not respected."