Interview with Klaus Regling, Managing Director, ESM

Published in *Frankfurter Allgemeine Zeitung*, 19 December 2015

Interviewer: Werner Mussler

FAZ: Mr. Regling, after the euro area states agreed on a new, third loan programme for Greece in July, the [German] Federal Finance Minister made clear for some time that he thought Grexit would have been a better solution. What was your opinion at the time?

Klaus Regling: Grexit remained a possibility while the Greek government rejected reforms, in other words until the heads of government reached an agreement with Prime Minister Alexis Tsipras in July. One can also take the view that new loans do not increase incentives to alter economic policy. I said at the time that Grexit would be the most expensive solution for all concerned. Plausible calculations showed that Grexit would shrink Greek GDP by some 25%, after it had already fallen by a quarter over the previous five years. That would have had a massive impact on 11 million Greeks.

What would Grexit have meant for the euro area States?

If Greece had left the euro area and devalued, creditors' loans would have been lost to a large extent. Greece would not have been able to pay them back. That's why Grexit would also have been very expensive for the other euro area countries.

Does this argument – that Grexit would be more expensive – continue to apply over and over again in the future?

This question does not arise. Prime Minister Alexis Tsipras is currently delivering – this week all the reforms still needed this year went through parliament. But, of course, I can't guarantee that this will always be so.

The government has carried out some reforms. But the impression remains that the fundamental reforms have all been pushed into the new year.

This impression is deceptive. It was always clear that pension reform and the next steps on Greek debt would only be tackled with the first comprehensive review of the reforms, the so-called 'first review'.

That first review should have, however, been completed in November; now it is only set to begin in the new year.

That's true. In Greece things sometimes get stuck. One should not, however, equate that with unwillingness to reform. There are reasons for these delays, not the least of which is the weakness of the Greek administration; it is often unable to cope with the concrete implementation of the reforms. Leading Greece to a European standard is the task of a generation. But the fact remains that the Greek Government is now willing to reform.

What makes you so sure?

One can never be sure. But the government knows that it will only receive additional ESM loans if it carries out reforms. And if it does not get the loans, then it cannot meet its payment obligations to the ECB and the IMF. If that were the case, then one could not rule out finding ourselves back in a similar situation to mid-year. The government also knows, however, that the country can only recover long-term if it sticks to a reform path.

In spring, the IMF must decide whether to add a further programme for Greece, thereby remaining part of the creditor institutions. Would you be in agreement with that?

Yes, of course. The ESM Treaty provides for IMF participation in principle; for that reason, I am in favour. I am also convinced that this is what will happen.

What do the euro area countries need the IMF for?

It is true that the IMF is no longer quite as important as a lender. The ESM could easily finance the 10% of the programme that the IMF is currently providing in Cyprus, for example. But we can continue to benefit from the IMF's economic and technical expertise in programme monitoring.

The IMF insists that the sustainability of Greek public debt be guaranteed. Would it not be most honest for European creditors to agree to a 'classic' haircut?

That would be impossible for legal reasons, but it is also unnecessary to achieve debt sustainability. Given our low interest rates and the long duration of ESM loans, the issue of debt sustainability will not even arise in the coming years. And the debt ratio will, because of the low debt servicing costs, slowly but steadily sink as reforms are implemented.

To what level?

The debt ratio in and of itself is not a good criterion for debt sustainability. Japan has a ratio of 250% of GDP, but no one considers Japan over-indebted. Other countries have gone bankrupt with ratios under 60%, Argentina, for example. In any case, if Greece resumes continual growth and the agreed primary surplus is permanently achieved, then the debt ratio will decline. In 15 to 20 years, it could fall under 100% of GDP again. But as I said: only if the reforms are implemented.

What do the euro countries need to decide on in the spring to preserve debt sustainability?

The possible parameters are known: maturity extensions, postponement of repayments, and, potentially, the further deferral of certain interest [payments]. How exactly these will be combined in the end is up to the Eurogroup.

The ESM loans for the third programme have an average maturity of 32.5 years, with repayments beginning on average only 15 years after the programme ends. The interest rate is less than 1%. Is it even possible to make it easier for Greece?

Technically, it's possible, largely because of relatively high debt servicing obligations that appear in about a decade. They can be smoothed. And if Athens uses this time of low debt service for reforms, then both sides – Greece and the creditors – will have won.

German taypayers see that differently.

The programme will not burden the German taxpayer, even though the German government is obviously taking on some risks. The ESM, given its good ratings, goes to the market for funds at very good conditions, which we pass on directly to the countries receiving loans. We only charge these countries our borrowing costs which are currently less than 1%.

And you continue to believe that the loans will be repaid?

Why not? Greece was on a very good path through the end of 2014, before the January parliamentary elections. There was growth again for the first time, and unemployment had fallen by two percentage points. The country had issued medium-term debt on the market. That showed that conditionality was working. If the agreed-upon reforms are carried out in the coming years, then the country can repay its loans.

In the 1990s, at the Federal Finance Ministry, you participated in the development of the EU Stability Pact. Then, at the European Commission in 2004, you pushed for action against Germany and France, because the two countries had broken the Pact. At that time, the Pact was simple; now is consists of innumerable detailed regulations and exceptions. Do you consider that a good thing?

The 2005 reform of the Pact was indeed a good thing, because during the financial crisis that soon followed many countries were no longer in a position for economic reasons to adhere again quickly to the 3% deficit criterion. But now the Pact, given many detailed rules, has become so complex that even the experts barely understand it. Rules can only play an effective role if they are understood.

The German Finance Minister wants to erect a 'firewall' between the Commission's budgetary supervision and the political Commission, as Jean-Claude Juncker envisages it. What do you think?

We need credible and transparent budgetary oversight. I travel across the world to interest investors in ESM bonds. The markets observe closely how the euro area conducts its budgetary oversight. The markets know that the Commission has been given additional budgetary oversight competencies. And they expect the Commission to use those competencies credibly.

You recently indicated that the ESM could, in future, issue foreign currency debt, in the medium-term even in Renminbi. Why?

We need to continually refinance ourselves on the market in the coming years, because our bond maturities are much shorter than the maturities of the loans we have granted. We are always looking out for the best conditions, and, therefore, a broad investor base is important. So far, we have only issued euro-denominated debt. If we want to reach as many investors as possible, then we will need to change that in the medium term. Large pension funds in the US invest only in US dollars, for example. Therefore, we are currently preparing for foreign currency issuance. Perhaps we will begin in 2016.

Earlier, the plan was to shut down ESM activities outside of times of crisis and keep it running with just a few staff. Now there is no more such talk. Why?

The EFSF and ESM have paid out more than €250 billion to more than five countries in the last five years. These loans must be regularly refinanced over the next 20-to-30 years. In addition, we need to invest our paid-in capital of €80 billion. These are large-scale market activities that must be accompanied by comprehensive risk management and sophisticated asset-liability management. The auditors also demand that we continuously observe the borrowing countries to ensure that they can repay our loans. All of this is not feasible with just a few employees, as initially planned. But do not forget: the number of ESM employees, currently at around 150, is not really that large.