European Stability Mechanism

Interview with Klaus Regling, Managing Director, ESM

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Korea Herald: What will the consequences of Brexit be for the British and European economies?

Klaus Regling: The U.K. has decided to leave the E.U., which is the epitome of cross-border cooperation in terms of free movement of people, capital, goods and services. I do see problems for the British economy, although the impact on the rest of the 27 E.U. countries would be relatively small, according to our research. One exception will be Ireland, which shares a border with the U.K., and exports half of its goods.

As an economist, I am convinced that trade, globalization and international cooperation are essential for raising living standards and growth rates. Trade between the U.K. and Europe will continue following Brexit, but at a lower level.

Brexit will not be good for the rest of the E.U. either, because European companies that export to Britain will experience less demand with a weakened pound sterling. Politically it's also costly for the E.U., because our relative weight in the world will decrease. This is why all European governments have expressed regret over the referendum's outcome. Nevertheless, it is the British public's decision and we have to respect it.

What is your perspective on regional economic integration worldwide?

As an economist, I firmly believe that cooperation is good for economic growth and raising living standards. Regional integration can play an important part in this respect. As an example, the ASEAN Economic Community is making significant progress.

But as the Brexit referendum and the U.S. election trends show, support for cross-border cooperation and free trade is waning. Somehow people don't believe in it as much as in the past. We have failed to communicate well enough with the broader public on its benefits. I am concerned about the increasing resistance to free trade, because it would bode ill for the world economy.
The backlash against free trade seems to be more prevalent in advanced economies than emerging markets, such as in ASEAN. This could be because developed economies have already reached high degrees of cooperation.

Tell us about the purpose of your visit to Korea and your organization.

The Global Financial Stability Conference 2016 in Seoul is linked to the G20 meetings, which are chaired by China this year. Out of many issues to be discussed, one major component is the global financial safety net that includes topics such as foreign exchange reserves of central banks and swap arrangements between central banks.

The IMF is at the center of the international monetary system, but we increasingly see that regional financial arrangements such as the European Stability Mechanism grow in global importance. In Asia, we have the Chiang Mai Initiative (a multilateral currency swap arrangement between the Association of Southeast Asian Nations, China, Japan and Korea), ASEAN Plus Three (a cooperation forum between the ASEAN and China, Japan, and Korea) as well as similar arrangements in the Middle East, Latin America and Africa. The question is how these elements of the global financial safety net can work together to be more efficient and productive.

The ESM -- a European regional financial arrangement -- cooperates with the Chiang Mai Initiative, as well as the ASEAN Plus Three Macroeconomic Research Office (AMRO) in Singapore.
When the Eurozone crisis began in 2010, member states of the Euro area created a regional assistance fund called the European Financial Stability Facility, which has morphed into the ESM two years later. I built both these institutions.
We issue bills and bonds to provide loans to Eurozone member states that have lost market access and are facing crises. We have done this with Greece, Portugal, Ireland, Spain and Cyprus. Except for Greece, the rest of these countries have exited their programs successfully and reentered markets. Thanks to substantial reforms implemented by these countries as a condition for financial assistance, they have experienced high growths. Ireland had the highest growth rate in Europe last year at roughly 8 percent, and Spain had 3 percent growth, which is quite high by European standards.

We adopt the same approach as the IMF, and it's working. We have disbursed 260 billion euros ($300 billion) since 2011, almost three times the amount disbursed globally by the IMF during the same time period.

What is the situation with the Greek debt relief?

We are in the middle of the third adjustment program in Greece. Greece has been the most difficult case we had to deal with, as other countries needed only one program, and implementation in Greece was interrupted in the first half of last year when the new administration of Prime Minister Alexis Tsipras took office.

Greece's economic problem occurred through a combination of factors. The country had the most severe misalignment out of the five -- the largest fiscal and trade deficits and other structural problems -- and needed to make the most difficult adjustment. Its weak administration also lacked implementation capacity.

But since last August, we are back in a cooperative mode, and if Greece sticks to the reform agenda, I am confident it will successfully exit the program in about two years' time.

I know that in Asia there are complicated feelings toward the IMF, with its reform programs bringing back painful memories. But after a while, reform leads to more successful economic development. Indonesia went through a very difficult period in 1997 and 1998 and people couldn't see light at the end of the tunnel, but two to three years later, it became one of the best performing economies in the world. This would not have been possible without the earlier reforms.

The Eurozone -- a monetary union of 19 of the 28 EU member states that have adopted the euro as their common currency and sole legal tender -- has been criticized for different reasons, chiefly for having a currency union without a fiscal union. What remedies are being put in place to salvage the Eurozone?

The crisis revealed some institutional gaps in the Euro area, and that countries were not implementing the appropriate policies. Countries ran into problems due to wrong policies. This led to some of them losing market access and needing reforms.

Over the years, fiscal and trade deficits accumulated in Greece, while in Ireland and Spain real estate bubbles were building up. When the bubbles burst, they paralyzed the countries' banking systems, necessitating state intervention and huge bailouts to rescue the financial systems.

However, through the work of EFSF, ESM and national governments, significant progresses have been made. The crisis was helpful in the sense that it offered countries opportunities to correct their problems.

Also on the Euro area level, we have strengthened surveillance rules for policy coordination, tightened fiscal rules and created new frameworks to cover issues such as divergences in competitiveness, credit bubbles and housing bubbles. We were not very good at doing this before the crisis. The ECB has also played a very important role during this crisis.

Finally, another big step forward was the Banking Union that was created two years ago. For the first time, Europe's largest banks are supervised at the European level rather than at the country level.

What can you say about monetary and fiscal policies in Europe?

On the monetary side, the European Central Bank has led the crisis relief effort, adopting policies that would not be prescribed in normal times, such as quantitative easing and negative interest rates.

Fiscal policy falls under the purview of national governments. As the euro zone is a monetary union with 19 countries, there are 19 fiscal policies, which all belong to an agreed framework to cooperate and keep deficits below 3 percent of GDP.

Given that debts have shot up over the last 7 years, all agree that deficits should be brought down. The general understanding in Europe is that fiscal deficits should be below 3 percent of GDP, and in good economic times, budgets should be balanced. Some countries have managed this while others have not. There are discussions about the speed of adjustment, but on the direction of reducing deficit, there is general consensus.

Some economists view debt as a bad thing, while others see it as necessary for long-term sustainable growth. What is your view?

Regling: Debt is an issue economists don't agree on. There are controversial debates centred on the level of debt that can be managed. Not every debt is bad. Countries can allow some debt to finance productive investment, infrastructure and education.

Korea has a low debt at less than 40 percent of its GDP, which would be considered a healthy level by most economists. But there is no agreement as to whether a debt is serviceable at 60 or 90 or 150 percent, as examples. It also depends on the interest rate that finances the debt.

Japan has the highest debt level among the OECD countries at 250 percent of GDP. But economists are not particularly worried, as the country pays an average interest rate of half a percent. Argentina, by contrast, defaulted in 2001 with a 50 percent debt, but at very high interest rates.

Greece has a relatively high debt at 180 percent, half of which is financed through my institution. The interest rate Greece is paying is very low -- between 0.5 and 1 percent -- and it is a bearable burden compared to market rates that are higher. This will give them time to grow out of their problems.

Germany, like all other European countries, saw its debt increase significantly following the 2008 global financial crisis, which contributed to the Euro crisis. National debts across Europe went up on average by around 40 percent, from about 60 to 100 percent of GDP. Countries that have deficits are trying to reduce the amount before balancing their budgets. In general, there's a consensus that debt is too high at the moment.

What measures are taken to address income inequality at European institutions?

The issue of income inequality is not my institution's mandate, and falls under the purview of national governments. The Gini coefficient -- the best known indicator of income inequality – shows that income inequality has deteriorated worldwide during the last two decades. But the deterioration has been much smaller in Europe than in the U.S. or China.

What the EU is trying to do through its budget is to narrow income differences between countries. The poorer countries, particularly in Eastern Europe, annually receive substantial net transfers from the EU budget through the European Commission.

Every country pays roughly 1 percent of its gross domestic product into the EU budget. As a result, richer countries such as Germany, France and Britain pay more than they receive, while poorer countries receive more than they pay.