Interview with Mr Klaus Regling
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Mr Regling, thank you very much for your time. I have to say that the ESM as well as everything related to the euro is very new for the Latvian public. Could you please explain to my listeners why, upon joining Eurozone, Latvia has to join the ESM too?

Yes, I understand very well that the ESM is new for the public in Latvia. The ESM is still a very young institution. It was created in October 2012. So it is just a bit more than one year old. But the purpose of the ESM is clear – to help contribute to the stability of the euro area. It is a permanent institution established by all members of the euro area, so every country that joins the euro area will also join the ESM. All the 17 countries that at the moment use the euro are Member States of the ESM. The Member States provide capital to the ESM so that those Members which do have temporary problems like losing access to financial markets in particular can borrow from the ESM to bridge the temporary period when there are problems. It is like the IMF, which works according to the same principle at the global level. All the Member States put in some money, and when they have problems, they can draw a temporary loan from the IMF. The same idea is behind the ESM.

So if Latvia had financial problems again, which I hope won't occur, could Latvia then rely on the ESM?

Absolutely, that is the purpose. The ESM is a permanent institution with the mandate to help its Member States in case they have serious problems. Then we can provide loans to such a Member State, as we are doing now. The EFSF – the temporary institution that was established in 2011 – and the ESM have provided financial support to Greece, Ireland, Portugal, Spain and Cyprus because they have or they had temporary problems in the markets. Two of these countries – Ireland and Spain - have been very successful and are now exiting their programme already, while the other three countries continue to rely on us. They receive loans against conditionality. That means that there are changes in economic and fiscal policies agreed and implemented. If they are implemented as agreed, then the loan is transferred in tranches from the ESM to the country. Any member has this possibility, so when Latvia joins the euro area, and few weeks later the ESM, it will have the same rights as all the other Member States.

But of course there are conditions to obtain the money?

Yes, of course. This is similar to the concept of the IMF. Economists call it conditionality. As I already mentioned: there is a programme agreed at the outset of such a support exercise, where during two or three years a country receives a loan from the ESM. But in return the country must implement agreed economic policy reforms. The purpose of course is clear – to improve the economic situation and the competitiveness of the country and to make it possible for that country to return to financial markets. The aim is for the country to refinance itself on the financial markets like before the crisis. This is the normal situation. But if this is temporarily not possible due to a crisis, then this is what the ESM offers, as the IMF does globally: loans against conditionality. And we can see that this strategy works. However, it is not easy. It can be painful for the country in question, and Latvia had this experience under the IMF and EU programme only a few years ago, but it pays off. Latvia for some time now has been the country with the highest growth rate in the EU. I know that unemployment rates are still very high, but they will come down. The economic fundamentals of Latvia are much, much better now after the end of the Latvian programme. This is the same concept we implement in all the countries that borrow from the EFSF or ESM.

How big is the contribution of Latvia to the ESM?

The Member States of the ESM have to finance the capital of the ESM. The ESM has very high capital, because we want to provide truly credible support for Member States and be an effective firewall that can reassure financial markets. Our overall capital is 700 billion euros, of which 80 billion euros is paid-in capital, so the 17 Member States have paid 80 billion euros. They gave us this money, and we manage it in Luxemburg. We invest it very conservatively as a protection for the bondholders. Latvia, when it joins, will have a capital share in the ESM of 1.94 billion euros, of which 221 million euros has to be paid in. This is Latvia's normal share, which is determined by the capital share of euro area countries at the ECB. Latvia will benefit in the first years from a temporary correction until 2026. After that Latvia's share will be a little bit higher.

The Parliament of Latvia will vote on Latvia's accession to the ESM. How confident are you that the vote will be positive?

You are right, parliaments need to approve and ratify the ESM Treaty, which is an international treaty. This ratification process is necessary and Latvian authorities and I have been in contact with the Latvian minister of finance. They are confident that this will be a positive vote. I hope so very much, because I think it is in the interest of Latvia and also in the interest of the euro area, and I am happy that we will hopefully soon have an 18th member.

You already mentioned your view on the economic situation of Latvia. Right now according the latest forecasts Latvia is doing pretty well. We are a fast growing country with low inflation. Being a very experienced economist, how sustainable are these economic indicators in your opinion?

That will depend on the economic policies in your country. Of course it will also depend on the environment in which the Latvian economy operates. But one has to always remember that every economy moves in cycles. One should never expect that data are permanently stable – this applies to inflation, growth rates as well as unemployment rates. There are cycles, there are developments determined by economic policies and by the environment. So as Western Europe moves out of the euro crisis, I am sure that this will translate into a more positive environment coming from that side. According to all forecasts that we have, economic growth in Western Europe will be stronger in 2014 than this year, and the growth rate will be even higher in 2015, so that will have a positive impact on the Latvian economy. But then it will be important for Latvia to continue the sound economic policy, and support growth through the right policies in the field of education, research, development and investment.

The ESM, as you said, is a firewall. How strong it is? How confident Latvian citizens can be that in the case of problems, they can be sure that there is a financial backup guaranteed?

I think Latvia and our Member States can be sure that this will be the case if there is a crisis that threatens the financial stability of the euro area or of a Member State. Also financial markets accept that the EFSF together with ESM are functioning well and that they can effectively protect their Member States. I think we can really say today that if not for the creation of the EFSF and then the ESM, countries like Ireland and Portugal would no longer be in the euro area. That would be a big loss for the euro area and it would have changed the nature of the EU, I am afraid. So this is a very positive result of creating these institutions, these firewalls, which were not foreseen in the initial design of the EU. It was a gap in the institutional architecture of the euro area and now this gap has been closed. We are working successfully. And looking at the ESM, which has a lending capacity of 500 billion euros, only 50 billion euros out of that amount has been committed and used for Spain and Cyprus. The other programmes for Ireland, Portugal and Greece are being financed by the EFSF. Thus 90% of the ESM’s firepower is unused and uncommitted. That is good news, because we still have substantial firepower available in case there is a new problem, which I hope does not come very soon.

How confident are you that no country will leave the Eurozone?

I am very confident, because the experience of the current crisis has shown that countries are willing to accept very hard medicine, very tough adjustment measures in order to stay in the euro area and EU.