

Klaus Regling in interview with Ansa, DPA, EFE, ANP, AFP

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12/05/2020

Interviews

ESM

Online



Interview with ESM Managing Director Klaus Regling

Published in Ansa, DPA, EFE, ANP, AFP

Interview conducted on 11 May 2020

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Original language: English

Question: What is the actual role of the ESM? We know what the ESM's role is in providing the loans but does it also have a role in monitoring, and how does the Early Warning System work?

Klaus Regling: The European Stability Mechanism (ESM) is part of the European response to this crisis, which is unprecedented and therefore it requires unprecedented responses at the national level and at the European level. We know that at the national level, if we add up everything that has already been put in place, it amounts to something between 12 and 17 percent of Gross Domestic Product (GDP) on average for the euro area as a whole, so that's a lot, that's unprecedented. Just like the GDP drop this year will be unprecedented. We have not had this since the end of World War II. And also the increase in fiscal deficits and public debt will be unprecedented. Therefore, there needs to be strong national responses complemented by a strong European response, and the ESM is one element of this European response. An important element but only one. You have to look at it overall.

There is also what the European Commission will do with its SURE programme, and the European Investment Bank (EIB), which will increase its lending activities to trigger €200 billion in additional lending. The last element is that the European Commission will present a proposal for a recovery fund. There we don't have the details yet. What is important, and I always emphasise that, is that the European response, whether from the Commission, the EIB or the ESM, is designed and will be implemented in a way that countries that suffer most in this crisis will receive more assistance. This is very deliberate because we know that at a national level, not all countries are able to respond in the same way. We do have a symmetric crisis but the national level is a little bit asymmetric. To compensate for that, the European response will help a lot.

Now I come to the ESM. It's our role to mobilise the money in the markets. We issue bonds, when a country requests a loan from us. We will do that, with the big advantage that interest rates are very low. At the moment, that's basically around zero, because our 10-year bonds in the secondary market are trading at slightly below zero. Then we add a very small margin for our operational costs, so it is basically zero. And we can provide money very quickly. And this is part of the broader European response.

On the monitoring, I know that this has raised questions in several countries, not only in Italy. Here it is important to understand that the ESM has changed its role compared to the last crisis, because the last crisis, the euro crisis, was a very different one. That crisis was triggered because policies had been wrong in several countries for many years. And that's why countries had very large fiscal deficits,

very large current account and trade deficits, which indicated a big loss in competitiveness. This had to be corrected and therefore the conditions had to be targeted to those problems. That's how we got the reputation that we are always very tough. But we had to be tough at the time because there were problems that needed to be corrected.

This crisis is different. It's a crisis that was not triggered by wrong policies. No government can be blamed for what is happening right now. It's a crisis that hits every country around the world not only in Europe and therefore it is very appropriate that the conditionality that we had 10 years ago does not apply now. So as you have read, the only condition linked to this Pandemic Crisis Support will be that the money provided by the ESM will be spent on health sector issues, direct and indirect costs. So it is linked to this crisis, very appropriately, and there is nothing else, also not later on.

What we call Early Warning System, this is part of the ESM treaty. We do what every creditor does. If you take a mortgage from a bank, the bank will also want to look at your income statement once a year to be sure that the loan will be repaid one day, so we do the same thing. We analyse the repayment capacity for the next 12 months and whether there is any risk that the payments due might not be made. By the way, even that was, 10 years ago, no more than what I described now. The Early Warning System only looks at the risks to repayment. On conditionality, that was completely different, and there is no justification to repeat that now in this type of crisis.

Don't you think that asking an ESM credit line might send a negative message to the market, making yields rise and so all the advantages of the cheap loans would disappear?

No, I think it's just the opposite. Markets fully understand how the ESM operates. They know that this is cheap money so the country that needs to finance its deficit is actually better off asking for some of the deficit to be financed by the ESM than doing all of it on its own in the market, because the interest rate is lower. This is good for the country's standing in the markets, so it will be actually helpful and from my frequent contacts with markets, with international investors, it is very clear that they look at it.

Now we are in a situation of frozen budgetary rules. But what will happen once the Stability and Growth Pact will be back? Do you think that the countries that requested ESM credit lines will be subject to stricter monitoring since the Commission and the ESM need to make sure that they can repay the loans?

First of all, the Stability and Growth Pact is still in place and actually working the way it's intended to work, because the Stability Pact has a special clause for special circumstances for a crisis like this. That's why there was a proposal from the Commission and a decision by the finance ministers to suspend the 3% ceiling for a while. We don't know for how long, that would depend on how the crisis evolves. But that does not mean that the Stability Pact is not working. This is part of the Pact, that is often misunderstood. So, what happens the next two years does not really depend on whether this exceptional circumstance clause is continued. Once the crisis is over, we can return to a normal situation, the Pact works and the monitoring that is linked to ESM lending is exactly as described in my previous answer. We do our EWS system as a creditor.

The Commission has made very clear in a letter signed by Commissioner Gentiloni that there will be no special monitoring. The Commission will do what they always do with all member states. It's called surveillance and that's its mandate from the EU treaty. That has nothing to do with today's crisis. It will look at the economic and budgetary situation in every member state. But the fact that a country may draw from the Pandemic Crisis support will not lead to additional monitoring or additional missions to the countries. And this is in writing from the Commission, including Commissioner Gentiloni.

Following up with the question on the general debt situation - German economist Lars Feld over the weekend warned that there might be another euro crisis like the one we saw ten years ago. Do you share this assessment? Does the ESM have enough firepower for that or do you need additional contributions from your member countries?

Lars Feld is one of the very well respected economists in Germany. I did not see his statement, so I don't know what he said about an upcoming new debt crisis. I know

what the European Commission said when it prepared the assessment for the euro area finance ministers last Friday in coordination with the European Central Bank (ECB) and also the ESM. The result was very clear: All euro area member states qualify for the Pandemic Crisis Support. That means that debt sustainability is a given in all euro area countries. That is the current situation. Otherwise, we would not be allowed to lend to a country. We don't know how many countries will request Pandemic Crisis Support. And those who might request might not draw on it. It is a precautionary arrangement. We also know from the International Monetary Fund (IMF) that a country that requests a precautionary credit line does not need to draw on it. But it has the right to draw very quickly in case of need. That is the advantage for the country. Therefore, it is very difficult to say how much money the ESM will need to raise in additional funds to lend. We know that in theory - if all 19 euro area member states were to request this facility and then would draw on it, which is a second if - that would add up to €240 billion.

But this will not happen, this is very clear. Not all euro area countries will ask for it and not all who ask will draw from it. If I make a very rough estimate, maybe one-third might become activated. That would represent €80 billion. That would mean given our current unused lending capacity of €410 billion, we would still have €330 billion for whatever comes at another crisis, which I don't want to predict and cannot predict. So the question you raise whether we will need to ask for additional contributions - you probably mean a higher capital for the ESM - is not at all relevant.

There is still a lot of concern, especially about Italy which is supposed to reach a debt level of about 160% of GDP this year. In this context another German economist, Clemens Fuest, raised the spectre of a haircut for Italy. Do you share this assessment or is anything of that sort upcoming? Could the ESM be asked to save Italy?

That is a question that I had to answer continuously over the last ten years and the answer was always the same: it was not needed because Italy never lost market access. When I started building up, first the EFSF and then the ESM, many academics, also famous academics, and many journalists came and predicted confidently to me that Italy would be the first client of the rescue funds. This has

never happened and I would be more cautious with these predictions.

We know that Italy's debt burden is high. But we also know that interest rates are low at the moment. There is one interesting aspect that many are not aware: If today Italy has a 10-year bond that was issued ten years ago that matures this week, and has to be refinanced, the refinancing will have a lower interest rate than what Italy had to pay ten years ago. That means the interest burden for Italy will go down with every bond that is refinanced, at the moment, because interest rates were a lot higher ten years ago. Italy is part of the Commission assessment that I talked about. That shows that with the help of the ECB and the ESM, all euro area countries are sustainable from a debt perspective today. Most economists expect interest rates to remain very low for very long. There are good economic reasons for that. So, also high debt burdens can be financed. As I said, at the moment for every refinancing operation the interest rate comes down for the Italian budget.

On the planned recovery fund or recovery instrument: We don't know the details yet. Do you see a role for the ESM in the whole context of the recovery plan?

The recovery fund will be one important element of the European response together with the EIB and what the Commission has announced so far, the SURE plan. So, the recovery fund will be important. It will also be very important in order to compensate for some of the asymmetry in some of the national responses. The Commission will present a proposal either late this week or next week and I don't know the details yet. It is a difficult exercise because it will be linked somehow to the EU budget and we will start a new 7-year cycle for the EU budget in the beginning of next year. So to link it to that makes a lot of sense. That is the only way in which countries can, to some extent, receive grants. Grants can only be distributed via the EU budget. That is what the EU budget does all the time anyway. It has the experience, it knows how to do it, it can be channelled via specific programmes. But it is not easy. It is never easy to agree on a 7-year cycle. That in itself is every seven years a difficult, complex political process. Now to add the recovery fund may make it even more difficult. But it is nevertheless very important. There will be a proposal but I don't know the different elements yet. You all heard Commission President von der Leyen say that some of it will be in grants and some of it will be in loans. That will be important. Some member states should receive some grants. But to see how exactly this will be organised, we have to wait another week.

Would you recommend to Spain, for example, whose finance costs have raised moderately since March, to draw from the pandemic crisis line? And how much could a country like Spain, who will be entitled to draw for example around €24-25 billion from the ESM, save if they were going to get the money from the ESM instead of getting it in the market.

Spain is obviously one of the 19 member states of the ESM. All of the 19 member states agreed on this new instrument on Friday evening. Politically some countries still have to close parliamentary processes and then it will be operational next week on Friday. But politically, we reached consensus, all 19 countries agreed. And it is very clear that it is designed to be available for all 19 countries. All the 19 countries were sitting there, the ministers all agreed on the details, they all know it is available for each one of them. I will not make any recommendation to any particular country.

But the facts are clear. All of our 19 member states will have very large fiscal deficits this year, so to finance a part of that in safe way, with low interest rates, could be attractive to many countries. Particularly because there is no conditionality attached to that, only the condition that the money is spent on health sector costs, direct and indirect, linked to the pandemic. And that will be easy to meet by all countries. So all countries could receive 2% of their respective GDP [2019]. Every country can make the calculation what is the cost advantage. And for Spain, I looked this morning, 10-year Spanish bonds had a yield of just below 1% in the secondary market. The ESM is around 0%. So you can easily make the calculation, it's just below €200 million per year, which over a 10-year horizon, and that is the other element agreed by finance ministers, that the loan will have a 10-year maturity, will add up to €2 billion euros for Spain. If you do the calculation for Italy, it will be €7 billion, because interest rates for Italy are higher.

But of course these interest rates fluctuate every day, so these are orders of magnitude as of today. So it is larger for some countries, smaller for others. But for half of our member states, there would be savings related to the ESM loan. And also it is in a way "safe money", we will not run away in the next crisis. We put money in Spain before, but also to Ireland, Portugal. And countries know that our money in their country is safe, we are the largest creditor, we will not withdraw it if there is a

large problem - so it is reliable and it is cheap. So these are the advantages. But every government has to decide on its own whether they want to make a request or not.

One question on the use of the money that the countries can get from the ESM. There is still not full clarity on what could be considered indirect costs and could you give a concrete example what would be these indirect costs, because, apparently tourism, transport, catering, are things that would not, in principle, be directly linked to this health care related costs.

Well, indirectly yes. Since the end of last week, it's now pretty clear, the European Commission will be in charge of monitoring how the money is spent if a country decides to draw. And in a way, there are three elements: The first is a direct cost, what are the additional costs foreseen because of the pandemic. But a second cost, and that is probably where an important chunk of the money to be used, is that a certain share of the current health sector costs in every country will be eligible. Because the available infrastructure is used also for the pandemic. So it is not only what needs to be spent to build another hospital, but also for existing hospitals that are used by people that suffer from the virus. Doctors, nurses, who are already there, have to be paid and a certain part of their work has now been moved to deal with the crisis. That is the second element. And the third is that some indirect costs are containment costs, because some containment is necessary to keep the overall [health] costs lower. Without containment they would be higher.

Every country that requests the pandemic crisis support should be able to demonstrate that they can easily spend 2% of their GDP [2019] on health care related costs, directly and indirectly. That is what counts and the Commission will do the monitoring.

On the recovery fund. What will be in your view the necessary amount? I know that the Commission is working on something around €1.6-2 trillion. If this support is channelled in the form of loans, do you think there is a risk of a deterioration in the future of the debt sustainability of countries with already high debt ratio like Spain or Italy? And what do you think will be an

adequate balance between transfers and loans that the Commission is trying to find?

I do not know the details that the European Commission will propose. I am sure it will be sizeable, and there is talk around €1 trillion. We will see. It has to be sizeable. This year we will deal with the pandemic, but then the recovery hopefully will start in 2021 and will last 2-3 years. So it will be long and it will be also costly. And many member states will have a hard time finding additional fiscal resources, so they need to rely on European assistance. So, it is good the Commission is working on this. The Commission President said some of it will be in grants, and that is justified.

But then part of your question I need to clarify. You said part of it is a loan and then the debt situation might deteriorate. But that is not true, because if there is a fiscal deficit, and each of our 19 member states will have a deficit, that is very big this year, unprecedented. Bigger than during the financial crisis and the euro crisis ten years ago. So they have to be financed. So even if it is a loan, either from the ESM or a loan from the Commission, it would help to do it more cheaply and more easily.

The money would be provided by the institutions and the country itself would not need to have to raise the money. Because that is the alternative: without a loan from the ESM, without a loan from the Commission, the entire deficit has to be covered by borrowing of the country itself. So that is probably more expensive and may not be so reliable, it might be withdrawn in the next crisis. So, one should not downplay the importance of loans in this context. But I also hope that some of this will come in the form of grants.

The ESM, as mobilised now, is totally different from what it was before, you already explained that a little bit. Does that mean that the ESM will no longer be the way that it's working now? With monitoring and everything?

You're absolutely right, and I said it before – the way we operate now is different from the last crisis. Except that on the lending side, we are still doing it the same way, we issue bonds to international investors to have money that can be used as loans to member states, so that is the same. But otherwise, the ESM, like any crisis fund or institution, is adapting to the circumstances. When you look at the history of the IMF, which was created over 70 years ago, we learned a lot from them on our

lending activities - except that we have to raise our money in the market, and they get their refinancing from central banks. But on the lending side, we learned a lot from the IMF.

The IMF has also changed over the decades, several times. Initially they were created to defend the Bretton Woods system, which was a system of fixed exchange rates; that was their main task. Then the Bretton Woods system was discontinued in the early 1970s. Some people said that the IMF was no longer needed because its original purpose was no longer relevant. And that was the wrong conclusion; the IMF adapted, and they were very successful in dealing in the 1980s with the Latin American debt crisis, and in the late 1990s with the Asian debt crisis. And now they are changing again. They, like us, are now focusing more on emergency financing for the pandemic, with basically no conditionality.

So it's a little bit the same story at the ESM. It would be really bad, I think, to be totally rigid and inflexible, to say 'we only do what we did 10 years ago, we will never deviate from that'. We are a crisis mechanism. Our member states, all 19 of them, have given us a lot of their money to be ready to use that money in an efficient, effective way, to deal with any crisis that comes along. We all hope that there are not too many crises, but this crisis shows that something can happen very quickly, very unexpectedly, very differently than in the past. So we have to adjust to that, and we did, of course with the support of our member states.

We, the ESM management and staff, made proposals on how we could be helpful in this situation that is very different from the past. It took a few rounds of discussions because there was no agreement from the beginning on how to do that. But now we can offer an instrument to our member states that is well tailored to the circumstances of today. So that's what we can offer, and it does not mean that we are obsolete. I don't know what happens 20 years from now, but we were very responsive to adjust to this crisis with this instrument.

You said something about the MFF already, you don't know details, but you said it needs to be sizeable, but what do you hope to find there? What do you think is needed? For example, in the op-ed you wrote a few weeks ago, you said that Italy would not have to pay a net contribution - do you think that other net payers would agree to that? How do you see this? Can

you elaborate a little on that?

It will be a difficult political process, but as an economist, and as a European citizen, and also as somebody who manages the ESM, I want to see a well-functioning monetary union. And at this juncture, a well-functioning monetary union needs some special support for countries that suffered most in this crisis. This is already how we've designed our own instrument, that's how the EIB will implement its special envelope of €200 billion of additional lending. And that's also how SURE, the programme from the Commission that is known already, how that will work. All these three institutions will implement what has been agreed so far in an asymmetric way, benefiting more those who suffered most. Because this is a symmetric crisis; everybody is hit, and no politician is responsible for that. But the response at the national level is very different.

In the same way, the recovery fund, which will be linked to the MFF - will also be designed in a way that there is solidarity with those countries that are particularly hit, and are not able to help themselves as much as others. This is the general principle, which has been applied in the European Union for the last 60 years, since the beginning of the EU - the EU budget was always designed in a way that the richer countries pay more than they get out, and the poorer countries get more out than they pay in. So this is a principle that has worked for more than 60 years. In the current situation, listening to our member states, everyone has said that the recovery fund will be designed to help more those who need it.

I have no doubt that as always in Europe, there will be a difficult political process; there will be different national views, but what we have seen with the ESM in the last two months is, that in the end, we have been able to come up with a result that everybody can live with. The net contributors and the net recipients. I expect the same to happen with the recovery fund, and the MFF. The MFF only becomes operational in 2021, so there is a bit more time. It's good now that we have an agreement on the ESM and its Pandemic Crisis Support, on the EIB, on SURE. All this can bridge the time until the next MFF becomes operational. So, on the principles, I can see how it will come out, but the details and the precise amount, I cannot say today.

Going a little bit deeper into this, there have been a lot of fights between the South, and specifically my country - being told off

to show solidarity. Do you think the Netherlands have toned down a little bit, and showed more solidarity?

We had a difficult political process, but actually not a very long one. I'm used to longer difficult periods. The crisis hit three months ago; we started looking into what the ESM can do two months ago. It's a record time that we were able to come to an agreement. And initially, there were different views; this is very normal in Europe, we should not be surprised by that. And sometimes the rhetoric gets a little bit out of control. The Dutch government has said the communication was not ideal. But that there are controversies, is part of life. What counts in the end is that we do come to an agreement, and as far as the ESM is concerned, that agreement was reached on Friday, unanimously, and we have a result that everybody can live with, and that's what counts.

Our minister said there is always the possibility of veto by one of the members of the Board - does it still work like this, or is that off the table now in the new ESM?

No, that's true, that's part of how the ESM works. It's in our Treaty, so that cannot be changed easily. It would require changing the ESM Treaty, which is a long process, it requires ratification in the 19 national parliaments. So that is our normal working. But after we reached a clear consensus, a unanimous decision by all 19 member states, I expect that to be confirmed in the parliaments of those countries where the parliamentary procedure is required. I would not expect at all that when the individual requests come in, that there will be a problem.

Has the ESM already been approached by countries interested in receiving this support and if not, which countries could be interested?

No country has approached me or the ESM, which is not surprising because until Friday there was no final agreement, so it would have been really premature. And even this week, I don't expect any requests because we wait for Friday to make it legally operational (at the Board of Governors meeting) and then we see. It's up to the countries. It's an offer to all 19 member states. The analysis, the assessment by the European Commission, the ECB and the ESM says clearly that all 19 countries

would qualify if they make a request. So they can have assurance that if they make a request, they can also draw the money. And we will see who considers that to be useful. I gave the reasons.

The money would be available quickly at almost zero interest rate, and it would be safe financing because all our member states will have big fiscal deficits. It is not their fault. They have no choice. They need to run deficits in response to the crisis and to have a large chunk of that finance safely. Money coming from outside the country and not its own national debt office, can be attractive for some, particularly at zero interest rate. So we will see what happens.

A question on Greece. What do you think of the situation in this country? The debt level is exploding. Do you think that a fall-back into a crisis is possible in Greece?

Greece is a country that we follow particularly closely because we are by far the largest creditor. Greece received more money from the ESM than any other country during the euro crisis. That's why we are very closely involved. Actually, my last business trip before I had to either stay home or in my office in Luxembourg, my last trip was to Greece for meetings with the government, with the finance minister, the central bank governor and the prime minister. It was just the beginning of the crisis and we had some preliminary talks what to do. I must say Greece is now recognised to be among those countries that have dealt well the pandemic. There is a relatively small number of infected people and a very limited number of people who died. So there has been great success, in that sense, and we can only congratulate Greece on that success.

When you say that the debt is exploding, I think that's not true. It is going up, of course, because Greece will run a large fiscal deficit, like everybody else. The problem, on the one hand, is that the extra debt comes on top of the highest debt ratio in Europe. That is true. But when you compare debt ratios, you must realise that in the case of Greece, more than half of their debt is with the ESM, so it is at very, very low interest rates. So in that sense, the annual debt servicing cost for Greece is lower in terms of GDP than in many other countries. That is why their debt is manageable although they come from a high level. They will add [debt] like all other countries but they are not in that sense different from our other member states.

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