

# Introductory Statement on Finance and Monetary Policy, Ljubljana

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Speeches

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Introductory Statement at the meeting with the members of the Committee on Finance and Monetary Policy, the Committee on European Affairs and the Committee on Foreign policy of the Slovenian Parliament

Good morning, Ladies and Gentlemen, I would like to thank the Slovenian Parliament for this invitation to talk about the European Stability Mechanism. I assume that you will be particularly interested in the new ESM programme for Greece since I am aware that the parliamentary committees considered the programme in detail before it was approved.

The ESM Board of Governors agreed the programme on 19 August. Greece will receive a loan of up to €86 billion in several tranches over the next three years. The government in Athens will use the money for debt service, bank recapitalisation, clearing arrears, and budgetary financing.

On 19 August, the ESM Board of Directors decided on the disbursement of the first loan tranche of €26 billion. The ESM transferred €13 billion to the government in Athens which used it mainly to redeem a Greek government bond at the European Central Bank (ECB) and to repay a European loan for short-term financing. A further €10 billion went in the form of ESM bonds to an account managed by the ESM. This money can be used to recapitalise Greek banks provided Europe's Single Supervisory Mechanism, the SSM, thinks this is necessary and the European Commission's Directorate General Competition gives the green light. Furthermore, €3 billion can be disbursed to the government through the end of November if Greece has by then met specific reform requirements – so-called prior actions.

With regard to the banking sector, the Single Supervisory Mechanism will determine its recapitalisation needs based on the Asset Quality Review and Stress Tests which are to be carried out before year-end. To increase bank capital, the bail-in instrument will apply to shareholders and to junior and senior debt bondholders before any ESM funds are used.

I am aware that the new ESM programme in Greece has stirred controversy in Slovenia as well as in many other euro area countries. Although ESM financial support does not entail transfers of funds from state budgets and therefore the Member States are not lending to Greece directly, I understand the concerns about risks related to taxpayers' funds, which underpin the ESM's and EFSF's financial strength. Furthermore, some commentators have been challenging the effectiveness of the programme's conditions and its design. Let me address these two issues.

As regards the total exposure, the financial assistance programmes contain a number of elements that protect the ESM's balance sheet.

First, as in other cases, the ESM disburses funds only after the country has implemented reforms to which it committed in its Memorandum of Understanding. The aim of the reforms is to improve Greece's fiscal sustainability and provide financial stability, thereby protecting the euro area from potential spill-over risks. They also aim to foster growth, competition, and investment and to ensure that a modern state with an efficient administration emerges in Greece. These positive developments are built in to the programme to enable Greece to stand on its own feet again and honour its loan commitments.

Second, an important element of the ESM programme is the creation of a privatisation fund. The Greek government will manage this fund, but the European institutions will supervise it. The proceeds from the sale of Greek state assets will be used, among other purposes, to pay back the ESM. It is important that part of the Greek sovereign holdings can be seen as protection for ESM's claims. They will also be used to reduce debt and finance investments.

Third, as regards the total exposure, I don't expect that the ESM will have to pay €86 billion on its own. In fact, I expect that IMF participation will lower the ESM's share in financing the programme. What is more, should Greece implement the reforms, I think it is possible that the government in Athens will regain investor trust before the end of the programme and that the government will be able to issue bonds at an

acceptable cost. The result would of course be that the ESM would disburse even less money. Such a prediction may sound optimistic today. But Ireland, Spain, and Portugal have managed to do this and all three are former programme countries of the rescue funds. Under its predecessor programme, even Greece was on a good path until the second half of 2014: in summer last year the country was able to issue two medium-term bonds. For the first time in six years, the country enjoyed positive GDP growth.

Finally, the ESM benefits from preferred creditor status that is junior only to that of the International Monetary Fund. This means that Member States grant priority in meeting their obligations to the ESM over those of other creditors. This mitigates repayment risk also in the case of Greece. The strength of the status will be reinforced once the government regains its ability to issue bonds in the market and the rescue loans represent a lower share of the total credit.

Let me turn to the concerns surrounding the effectiveness of the conditions embedded in the programme, particularly with respect to debt sustainability. I respect and understand the arguments of the sceptics, although I don't share them. I will do my best to explain with facts and arguments why I believe that the ESM programme was the right decision to take.

As misunderstandings sometimes arise, I would like to stress that helping grant a crisis country without market access temporary rescue loans at advantageous conditions and against conditionality is an approach that the IMF has been successfully applying globally for more than half a century. Furthermore, such debt relief can help a country stretch necessary economic adjustments over time, making them more socially acceptable than an overnight implementation.

As an example of such practice, Greece will only begin to pay interest and redeem principal in 2023 on the outstanding EFSF loan of €130.9 billion. The loan maturity is 32.5 years and therefore very long. The rescue funds enjoy very high creditworthiness among investors. That makes our financing costs very low – around 1% – and we pass our low financing costs directly on to Greece. According to our calculations, Greece is saving around €8 billion a year as a result of the advantageous loan conditions. This is equivalent to about 4% of Greek GDP.

Similar conditions apply to the new ESM programme. The weighted average loan maturity is 32.5 years. Greece will start redeeming on average around 15 years after

the three-year ESM programme ends. The interest rate is around 1%. However, Greece will pay interest from the start.

When people look at debt sustainability they often look at the ratio of debt to GDP. This ratio is indeed very high for Greece, but I don't think it's very telling. Much more relevant for the European programme countries is a country's gross financing needs. They show that Greece needs less to finance its debt per year as a result of our beneficial lending conditions than, for example, Italy or Spain.

Still, I see possibilities for talks on further debt relief in autumn. There could be discussions on further maturity extension of our loans, further interest rate deferral as well as renewed transfer of the profits that euro area central banks have made from purchases of Greek government bonds in the context of the so-called SMP programme. However, these talks will only happen if the next Greek government implements the agreed reforms and if the institutions confirm this in their programme review.

Overall, our five years of experience with EFSF and ESM programmes in Greece, Cyprus, Ireland, Spain, and Portugal make me confident that our crisis strategy is working. The rescue loans and the reforms delivered positive economic developments, albeit with a time lag. International organisations like the OECD and the World Bank have certified that these countries have become reform champions as a result of their programmes: budgets were consolidated, painful structural reforms were undertaken, competitiveness improved. The unacceptably high unemployment levels began to sink. Countries like Ireland and Spain today enjoy the highest-growth rates in the EU. This shows that the crisis strategy is working.

## Author



[Klaus Regling](#)

Managing Director

## Contacts



[Cédric Crelo](#)

Head of Communications and Chief Spokesperson

+352 260 962 205

[c.crelo@esm.europa.eu](mailto:c.crelo@esm.europa.eu)



[Anabela Reis](#)

Deputy Head of Communications and Deputy Chief Spokesperson

+352 260 962 551

[a.reis@esm.europa.eu](mailto:a.reis@esm.europa.eu)



[Juliana Dahl](#)

Principal Speechwriter and Principal Spokesperson

+352 260 962 654

[j.dahl@esm.europa.eu](mailto:j.dahl@esm.europa.eu)