Klaus Regling in interview with Der Spiegel (Germany)

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Interview with Klaus Regling, ESM Managing Director
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SPIEGEL: Mr Regling, many years ago you negotiated the debt rules of the European Stability Pact for former Finance Minister Theo Waigel. Do you regret your involvement?

Klaus Regling: Why should I? The Stability and Growth Pact has worked better than many predicted. In economically good years, the euro area has often borrowed significantly less than the US, Japan or the UK. This shows that, by and large, EU finance ministers have behaved responsibly. But the world is a different place today. Many things that were right in the mid-1980s are not necessarily relevant in today's economic environment anymore.

Many in Germany see it differently. According to its electoral programme, the FDP, for example, wants to “fully reinstate” the rules that force EU Member States to exercise debt discipline and that are currently suspended because of the pandemic. Does this make sense?

I will not interfere in a domestic German political discussion; that is not my role as head of a European institution. Nevertheless, most economists who deal with this issue are opposed to reviving the pact unchanged. Yes, the monetary union needs fiscal rules; that is undisputed. But they must be adapted to the changed economic conditions.

What does that mean?

On the one hand, it was inevitable that almost all states expanded their fiscal deficits during the pandemic. Otherwise, the damage would have been much greater, also for public budgets. On the other hand, interest rates are much lower today compared to thirty years ago, so debt levels can be correspondingly higher without putting an additional strain on budgets.

However, quite a few economists expect interest rates to rise because of rising inflation.

Interest rates will not remain as low as they are today, but I do not know any economist who predicts interest rates of six to eight per cent for the foreseeable future, as was the case in Germany in the 1980s or 1990s. Fortunately, because in the Western industrial nations, digitalisation and climate change are creating a high need for investment.
The fiscal policy conditions are different today than they were three decades ago, and this will remain so.

This just does not sound like the culture of stability to which German politicians felt particularly committed when the euro was introduced.

Striking the right balance is key. There are limits to debt, and they must not be exceeded. But in Germany it is not uncommon for people to take the view that public debt is a problem in itself. That is wrong. Behind it is a fundamental misunderstanding about the causes of the low interest rates that have persisted for years.

Please explain.

Many believe that the central banks are to blame for the low interest rates. That is only a small part of the story. In fact, yields are so low because in the ageing societies of the West, savings outstrip what the economy can invest. The supply of savings is greater than the demand, and that is why interest rates are falling. If the country were now to stop borrowing, like many in Germany are demanding, the disparity would become even greater – and interest rates would continue to fall. Savers would be at a disadvantage, and they are the ones to whom the advocates of strict fiscal rules feel particularly committed.

But would not the Stability Pact lose all credibility if the debt rules were eased further?

You can also lose credibility by sticking to rules that have become economically nonsensical.

Which rules exactly do you mean?

Take the rule according to which countries with excessive debt must bring down their debt to the Maastricht debt threshold of 60 per cent of economic output within twenty years. As an example: if this was implemented to the letter, a state like Italy would have to achieve budget surpluses of 6-7 per cent every year. This is not feasible and does not make any sense.

Who knows – maybe it would even be healthy for a country that has lived beyond its means for years.

I do not think so. Italy currently has no problem servicing its loans. The country's debt level is about 50 percentage points higher than ten years ago, but the cost of borrowing is much lower because of the low interest rates. In 1993, the government in Rome still had to spend almost 12 per cent of economic output on interest payments. Today, it is just over three per cent.

Italy's debt level after the pandemic is higher than Greece's debt level before the outbreak of the euro crisis. Can you understand that this makes some people uneasy?

This example shows how important it is to take into account the changed [economic] conditions. And what would have been the alternative? If the government in Rome had not supported the economy with loans, the economy would have slumped much more during the pandemic and the debt level would then have really got out of hand. Now, Italian Prime Minister Mario Draghi has launched a promising reform programme with the money from the [European] recovery fund, which offers the best prospects of putting the economy on a growth course, and thus bringing the debt level down.

Is that not a bit too much optimism for a sovereign debt that has been rising steadily for two decades?

Of course, we must not be naïve, the reform tasks are enormous. However, Italy will replace old loans on a large scale with new ones at lower interest rates in the next few years. This contributes to the fact that the country’s financial situation is far better than some in Germany believe.

Many German citizens have simply lost confidence in the monetary union. It was promised that each country would be responsible for its own debts. Instead, there is a European system of mutual liability, which the constitutional court in Karlsruhe is also worried about.

There is no mutual liability system. During the euro crisis, the member states of the monetary union founded the ESM rescue fund, which – together with the predecessor EFSF – has provided loans totalling €300 billion to Spain, Ireland, Portugal, Cyprus and Greece. These loans have been serviced on schedule for ten years. There have been no costs to date for the German taxpayer stemming from the euro crisis.

But with a lot of risks.

The risks remain manageable because the ESM, together with the EU Commission, have closely monitored the use of the funds. The Funds were disbursed under strict conditions, so that the root causes of problems in each individual country could be addressed and solved. Also Ireland had to request financial support during the financial crisis. Today it is the country with the second highest per capita income in the EU.

The debt burden in Europe is only getting bigger. Meanwhile, many are calling for the EU's recovery fund to be made permanent, taking out more loans to make the economy more digital and climate-friendly. What do you

think of this?

First of all: debt is increasing, but due to low interest rates, the debt burden has decreased significantly. The recovery fund, by EU decision, is a one-off measure to deal with a severe crisis. That was reasonable and it should stay that way. The European treaties hardly allow for anything else. If the EU countries want more investments to be made, there is the EU budget and the possibility to borrow more nationally. In addition, there is the European Investment Bank (EIB), which has a special role to play when it comes to promoting private spending for the future.

In what respect?

The EIB issues bonds that are guaranteed by EU Member States and therefore have an AAA rating, i.e. a credit rating as good as the bonds issued by Member States such as Germany or the Netherlands. Economists speak of safe assets, for which there is a great demand on the international financial markets. The reason for this demand derives from growing savings all over the world and legal regulations that oblige banks and insurance companies to buy such safe assets. It is wise that the European Union contributes to a sufficient supply of safe assets.

Are you saying that EU countries should pile on more debt to provide enough safe assets?

In any case, they should not abruptly reduce their borrowing. Otherwise, interest rates could fall even further. There could be a shortage of safe investment opportunities for investors.

A reform of the European fiscal rules is currently being discussed in Brussels and in the coalition talks in Berlin. What do you recommend in concrete terms?

A reform that makes the Stability and Growth Pact more effective. The rule, according to which member states are allowed to run yearly deficits of no more than three percent of economic output, has proven its worth. It should be kept. The debt-to-GDP ratio of 60 per cent, on the other hand, is no longer relevant and should be adjusted to reflect the changed environment. Politicians should be aware that a country can borrow too much, but also too little.

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