Klaus Regling in interview with Luxemburger Wort

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Interview with Klaus Regling, ESM Managing Director
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Luxemburger Wort: Klaus Regling, in 2010, in the midst of the euro crisis, you were tasked with setting up the European Financial Stability Facility (EFSF) rescue fund. Describe the situation at that time.

Klaus Regling: It was a real crisis for Europe and the countries concerned. The euro itself would not have disappeared, but the monetary union could have become much smaller.

In that respect, everything had to happen very quickly. At first, an attempt was made to help Greece with €53 billion through bilateral action, but that was not enough. And it also became clear that it was not just about Greece, but also about a number of other countries. That's why the EFSF was created in a hurry.

How can you imagine setting up such a structure within a few months?

The legal requirements were created very quickly in night meetings of the Eurogroup. But then the institution had to be set up. After I was appointed, that was my job. And there was nothing there: no staff, no office, no telephone number, not even an e-mail address. The only thing that was there was my experience and the willingness of the other European institutions to help.

The European Investment Bank (EIB), the EU Commission, the European Central Bank each sent a staff member very quickly so that someone was there at all and I was not completely alone. The EIB allowed us to dock onto their IT system and handled the accounting for us. The German Finance Agency issued the first bonds on behalf of the EFSF. The Luxembourg government was also very cooperative in developing all of this. After two months, we were eight people and they had to work very hard. For example, we had to negotiate with the rating agencies. That was not easy at a time when they had been criticized by everyone, including me, for giving triple A too lightly. And then I came along and wanted to have a triple A as well for this new institution that nobody knew.

How long did it take before you were ready to work?

Speed was critical in that situation. Seven months after the creation of the EFSF, we had to issue the first bond, and that is quite unusual for a new institution.

It was also necessary, because we then needed the money already for the Irish program. If we had needed three years, the euro area would have shrunk.

There was no real model for such a fund. What did you use as a model for setting up the structures?

Yes, there was no provision in our monetary union for a country to lose market access. When it came to lending, we were guided by the International Monetary Fund (IMF). Not in the case of refinancing, because the IMF refinances itself through the central banks of the member states. But we didn't get any money from central banks.

We had to obtain the money on the market by issuing bonds, which was the plan from the very beginning. But what was done with the money and the principle of conditionality was based on the IMF model. We didn't have to invent anything new. We attached conditions to the loans in order to eliminate the problems that had led to the loss of market access.

Were there moments when you thought that, despite all your efforts, it might fail?

The risk that it wouldn't work was always there. We were really in a difficult position. One half of the international financial market believed the euro would disappear in the next few years. The majority on Wall Street and in London thought the euro would be gone after five years. That's why they weren't interested in buying EFSF bonds.

That's why, in the first months and years, I flew non-stop to Asia and the Middle East to convince investors there that we would get our act together. If that had failed, and the EFSF hadn't been able to sell bonds, then we wouldn't have been able to finance the programs, and then one, two or three countries would have fallen out of the euro. That was a really critical phase.

When we then succeeded, in the first half of 2011, in actually selling our bonds without any problems and subsequently being able to place €60 or €70 billion a year in bonds, we knew that we had done our part.

When everything has to happen so quickly, mistakes happen. Looking back, what would you do differently?

There were actually no mistakes in setting up the institution; in retrospect, everything turned out to be surprisingly correct. After all, the EFSF only granted loans for over two years, after which it was replaced by a permanent institution with a different structure in the form of the European Stability Mechanism (ESM). The EFSF was designed as a temporary institution from the outset.

So, I can't really see any mistakes. The governance of these structures is perhaps a bit cumbersome because all important decisions have to be taken unanimously. But we still managed to help five countries during the crisis with almost €300 billion.

On the contrary, the experience we gained during the crisis was essential for setting up the "Next Generation EU" program during the pandemic. This is based on a similar principle, using the creditworthiness of the member states to obtain a triple A and thus issue low-interest bonds. This is the first time this has happened to us on this scale.

Why was Luxembourg chosen as the location?

Luxembourg has traditionally been home to the EU's financial institutions. The European Investment Bank is the biggest example, but it is not the only one; the European Central Bank (ECB) is rather the exception. Therefore, it was a logical step.

During the pandemic, financial assistance from the ESM was not used. Has the ESM lost its importance as a crisis instrument?

I see the fact that our money is not being used at the moment as positive. After all, that is precisely our task, to prevent crises. The fact that our money is not being used does not make our work unnecessary. During the pandemic, we developed a new facility that is not necessarily intended to be disbursed. But it has a calming effect on the markets because they know that such a precautionary facility is in place that countries can draw on relatively quickly. The agencies have taken that into account in their credit ratings.

Of course, we already have the political problem that some countries say the conditions in the past were so tough, we don't want to draw on ESM funds. But the conditionality varies with the underlying problems. And in the case of the pandemic, there were no policy mistakes that had to be corrected. This was an external shock for which the governments could do nothing. And that's why the conditions for it were far less stringent.

Has the monetary union become more resilient since the euro crisis?

Yes, certainly. It was precisely the creation of the ESM that closed a gap in the architecture of the monetary union. Because now there is a lender of last resort for euro area countries. The ECB is not allowed to play this role under the Maastricht Treaty. It can only do that for banks.

In addition, we have created a large number of new European institutions, such as the Single European Supervisory Mechanism, the Single Resolution Mechanism and the European Systemic Risk Board with the mandate to analyse and contain potential risks. All this helps to better cope with today's crises. But the process should continue, there are other gaps that have not been closed so far.

Which ones?

For example, the completion of the banking union, the capital markets union and a fiscal capacity for macroeconomic stabilisation. That should lead to more convergence within the monetary union, because we would have more automatic adjustment mechanisms, as is the case in the US, for example, where individual regions also often move apart cyclically or structurally.

Because of the pandemic, war and energy crisis, countries are spending a lot of money. At the same time, interest rates are rising. Is there a danger of a new debt crisis?

I don't see that at the moment. In principle, of course, any country can move into a debt crisis by pursuing the wrong policies. The fact is that debt levels in the euro countries are higher than they were ten years ago because of the last two crises.

But the burden of debt servicing on national budgets has become much smaller. Just because interest rates are rising doesn't mean we're heading into a new debt crisis. It will take many years for rising interest rates to filter through to national budgets. Most countries have used the last few years to increase the average maturity of their debt. Eight years is now the average maturity in the euro area. For some, like Greece, it's even over 20 years because of our long-dated loans.

That means whatever interest rate increase happens, it takes time to be fully reflected in the budgets of individual countries. Apart from that, the current interest rate now is still much lower than the average interest rates ten or 20 years ago. The ratio of debt service to economic output is at its lowest level in 30 years. There's a lot of room for improvement.

How much room is there? Has the assessment changed in recent years as to how high the debt to GDP ratio can be without it becoming dangerous?

I think so, because the environment has changed. There is a variety of research that suggests that interest rates will be permanently lower in the future than they used to be, even though they are rising at the moment. That has to do with demographics and also with the unequal distribution of wealth.

Older and wealthier people consume less and save much more. And as a result of that, we have higher savings in the world, but that is being met with lower demand for capital. This environment will probably ensure for the next few decades that we have lower interest rates than before. This increases the capacity of individual countries to service higher levels of debt. The debt limit of 60 percent of economic output set out in the Maastricht treaties was correct at the time, but the limit could probably be higher today. To which no one can say exactly what the limit is.

I can see the moving boxes in the background. This is your last week at work. Does the haggling over your successor irritate you? Pierre Gramegna, the former Luxembourg Finance Minister, has already thrown his hat into the ring and withdrawn it again.

I've been familiar with European decision-making processes for many decades, and this kind of thing happens relatively often in Europe when it comes to personnel decisions. So it's not all that surprising. But of course I would have preferred that at the end of this week, when I step down, it is clear who will be my successor.

Do you have any advice for your successor? What qualities does he need to bring to the table? Should he be more of a politician or a technocrat?

It can be a politician or a technocrat. The important thing is to manage the institution well, but above all to be able to communicate well with politicians, with parliaments in our member states, with the media and, above all, with the financial markets. Because that was certainly a crucial task I had ten, twelve years ago, to convince the financial markets that we were doing the right thing against the euro crisis.

Would you like to say something about what's next for you?

There's not much to say. Only that it will continue. I'm happy to work a little less in the future than I have in the past 40 years. But I will certainly do something. But what exactly, I'll decide after my vacation.

Will you miss Luxembourg?

Of course. I feel very much at home here. It was really gratifying how closely we worked here with the Luxembourg authorities, with the government and the Ministry of Finance. And those are all very positive memories that I'm taking with me.

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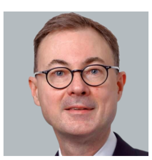

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