

Klaus Regling in Interview with Cinco Días (Spain)

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Interviews

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Interview with Klaus Regling, ESM Managing Director

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Interviewer: Nuno Rodrigo Palacios

Cinco Dias: Are you worried about Italy? It's the first time that openly eurosceptic parties rule in one of the big Eurozone countries.

Klaus Regling: We have to wait as there is no government yet, as we speak. There have been contradictory statements by politicians so we have to see what will actually happen. I am worried about some of these statements, as are many other people in Europe. But democracy is part of our lives. What is important now is what the new government's policies will be.

The market reaction has been negative, but not harsh, despite a government program that includes more government spending and lower taxes.

Yes, there is a clear reaction. The interest rates on Italian government bonds have been going up, they are now significantly above Spain, but the reaction has not been very strong. I guess the market has taken the same view I take, which is to wait and see what the new government will actually do.

Also, in August Greece is up to exit the bail-out programme. What is your view about these difficult years? What has Europe learned?

We have learned from every case. Greece is only one of the five countries that have received financial assistance from EFSF or ESM. Greece a special case because the country has been in a programme for eight years. That is very long, much longer than other countries. But there are reasons for that. One of these reasons is that Greece moved in the wrong direction in the first half of 2015. At that time, the government reversed many of the reforms that had been implemented earlier. And we had dramatic moments in the summer of 2015, when “Grexit” became a real possibility. Since then, there has been progress in Greece. Now there is a chance that Greece will also become a success case, after Ireland, Portugal, Spain and Cyprus. The country succeeded in consolidating fiscal deficits, it has had a fiscal surplus, not just a primary surplus, for three years. Additionally, many reforms have been implemented. There is still more work to be done to make the economy resilient. We very much hope the Greek government will continue the reform agenda of the last years in order to strengthen growth and employment, taking down unemployment rates. If Greece continues to reform, there is a very good chance that when Greece exits its ESM programme in August, they join the other former programme countries to become a success story.

But there’s still a lot of uncertainties about Greece: for example, about a precautionary credit line, debt relief, or post-programme surveillance.

Yes. Work remains to be done. On the reform agenda, we are in the middle of the final review of the ESM programme. Our final disbursement to Greece will depend on that, the review will have to be concluded successfully. A long list of reforms will have to be implemented. Debt relief will be discussed by the Euro area finance minister in the next few weeks. But progress is visible in Greece. Growth is back, the fiscal situation is ok, competitiveness is back. But as I said: The reform process needs continue in Greece.

Do you think debt relief will help Greece to become a success story?

In the short run Greece does not need additional debt relief. The country already received significant debt relief in 2012. Private creditors took the biggest haircut in history, more than 100 billion euros. Also, official creditors eased the payment terms significantly. This is helping Greece today. We estimate that debt relief from official creditors reduces debt service payments from the Greek budget by around 10 billion euros per year. That corresponds to around 5% of GDP. All of this has already

happened. We are now discussing additional debt relief. We are not at the end of that process. But I am confident that if Greece keeps up with the reforms, the finance ministers will come to some conclusions on additional debt relief either in June or July.

Looking ahead, what can citizens expect from euro area reform? What could the role of the ESM be?

The starting point is that a lot has already happened during the crisis. In the last few years, there have been significant changes in the functioning of the monetary union. The most important development is that countries that had problems, lost market access or were close to losing it, improved economic policies, implemented reforms and tackled problems, which were different in each country. Some countries had high fiscal deficits, others had real estate bubbles like Spain and Ireland. Other countries had a significant loss in competitiveness. As a result they accumulated big current account deficits. All the problems have been tackled by these countries. As a result, there has been a big improvement for the monetary union as a whole. Without this, the changes of the euro area architecture would not have been sufficient to get us out of the crisis. That is the reason why the countries who addressed their problems deserve a lot of credit. In addition, we improved the euro area architecture with the banking union, with the Single Supervisory Mechanism (SSM) for the systemically important banks, which comprise 80% of the system, and with the Single Resolution Board (SRB) and the Single Resolution Fund (SRF). Another important innovation was the creation of the ESM, including the EFSF, institutions that did not exist before the crisis and have been functioning well. Now, there is a discussion about how to strengthen the currency union further. Big institutional changes have already happened. Building on these changes, discussions are going on and decisions will be taken in summer to complete banking union. One decision relates to a backstop for the SRF, another to a European Deposit Insurance System (EDIS). Both issues have not yet been agreed. Work is still going on. Most countries support that the monetary union needs the backstop and the common deposit insurance scheme. But there is disagreement about how quickly it will happen and what preconditions have to be in place first. There is an ongoing political debate that can be concluded by June.

Are you optimistic about that?

It's important that all members support the establishment of the backstop and deposit insurance in principle. It is not so important if it is going to be next year or later. It is much more important that there is support for these institutional changes. Then we can spend some time to create preconditions that have to be in place before these changes take place.

What could the timeline be?

It could be part of the agreement in June.

There are quite different views about the reform needs in Berlin and Paris as far as a fiscal capacity for the Eurozone is concerned. On Tuesday, a group of German economists publicly slammed the Macron plan.

In Germany, there is a strong debate about these proposals. The 154 professors are one camp. But there are many other economic professors in Germany who clearly disagree with that. The debate on principles is useful. There is a discussion about strengthening Economic and Monetary Union (EMU) and there are two items under discussion: one is completing the Banking Union and another is how to further develop the ESM. A third big question is about a fiscal capacity for the monetary union. Most of the member states want the ESM to play a stronger role in the future. If there is a new adjustment programme one day, it will be probably the European Commission and ESM together who will be in charge of designing, negotiating and monitoring the programme. Of course, that has implications for our work at the ESM. If we do that, we need to be well informed about what is going on in the 19 members of the euro area, in order to be able to design a programme at very short notice. The ESM will also be asked to provide a backstop for SRF. There is also a legal issue. So far, the ESM is based on an intergovernmental treaty. In my view one day the ESM will be part of the European legal framework. But that will require a change of the EU Treaty. From my point of view, the model for ESM in the EU Treaty is the European Investment Bank (EIB). The EIB is mentioned in the Treaty, it has its own capital and can act independently. I don't expect the integration of the ESM into the EU Treaty to happen as proposed by the Commission. This proposal is not supported by the majority of the member states.

On the fiscal capacity issue, the view in Paris is to get a fiscal capacity within the euro; the German view is more restricted.

In my view, the Monetary Union should have some sort of fiscal capacity. We don't have that at the moment. What we do have in case of a big crisis is the ESM. But we should not forget we have the EU budget. It is not designed to support monetary union. But the fact is that the EU budget provides transfers from rich to poor countries. So the objective is that poorer countries can catch up with richer ones. Via the EU budget, there have been fiscal transfers for 60 years and they will continue to be there. That is useful. If we didn't have those transfers from the EU budget we would probably have a much more urgent debate on transfers within Monetary Union. In my view, we do not need additional transfers. But it is important economically to think about expanding the fiscal buffers on a national level because countries who comply with the Stability Pact do have the capacity to let automatic stabilizers work in a downturn and use the 3% of GDP limit for fiscal stimulus. But it's useful at the EU level to think about how to complement those national buffers with European buffers. That can be done by different mechanisms like "rainy day funds" or a complementary unemployment systems. Both systems exist in the US. An alternative could be an additional facility at the ESM.

But these mechanisms are not transfers?

No, the transfers are managed by EU budget. We can improve the efficiency of those transfers but we already have transfers

So it will be like loans?

Yes, like revolving funds where you can draw a loan from that has to be repaid in a business cycle, in 5 or 7 years, so the money flows back quickly and is available again for the next downturn.

But if we have conditionality we will again have the same division between the creditor and debtor states.

No, that is not the concept I am advocating. Those tools would be designed so that all countries can benefit, because all countries go through business cycles. That includes also countries that look stronger at the moment. They can also have downturns and benefit from these funds. That is a different approach from the ESM approach where you have had creditors and debtors in recent years.

About eurobonds. There is the EC proposal of creating a safe asset (by securitisation of government bonds). This week Ana Botín, the head of one of Europe's biggest banks, asked for debt mutualization. What's your opinion?

We are mixing many things together here. I would not call the Commission proposal a eurobond proposal because that is another concept. It would be very positive for the monetary union to have safe assets. This would cut the negative feedback loop between banks and the sovereigns. It would protect countries in crisis. But the proposals to create a safe assets in an artificial way, through financial engineering, would not really provide the safe asset we are looking for, according to many experts. It is positive that work is going on to find a way to create safe assets. But so far I have not seen a really convincing result. Rating agencies have said they will not give a AAA rating to such an engineered safe asset. We need to continue working on that. If we cannot find an artificial way to create those safe assets we will have to go the long way. We have to create trust among the member states and in the end of a long road, true mutualization can take place, but that is far in the future.

Spain is under post programme surveillance, what's your view on Spain's fiscal path? The Government is lowering taxes and upgrading pension benefits.

We know the forecast of the European Commission and of the Spanish government. It will be very good to finally reduce the Spanish deficit below 3% of GDP this year. Spain will be the last country in the Euro area to do so. I think given the good economic development of the last few years it should perhaps have happened earlier. But it is good that it will happen in 2018. Spain should continue on that path. We are currently experiencing positive economic developments in Europe and in the world economy. That will not last forever. Interest rates are very low. The Spanish budget benefits from that. There are two reasons why this is a good time to continue deficit reduction from a budget perspective. The economic good times will not last forever. It is good to be prepared for that, to build fiscal buffers now and to be prepared for a downturn. We are not predicting any crisis. But all economies move in cycles. After so many good years, and Spain has had 11 quarters of growth above 3%, there will be a downturn like in any other country one day. Not a crisis, just a cyclical downturn. If this happens, it is good to have fiscal buffers.

In the 2016 assessment, the Commission did not mention Banco Popular (6th of Spain) in its analysis of banking, months before its resolution. Don't you find it paradoxical given that both the program and the surveillance were focused on banking stability?

I cannot comment on the work of supervisory authorities. But it is positive that a solution was found very quickly and now the Spanish banking system is much stronger than a few years ago. That is important.

There has been criticism on the lack of transparency in this process.

This is something you should discuss with the SSM. I don't think we should have complete transparency in banking supervision with market sensitive information. If everything is made public, it wouldn't work.

In Italy, Greece and Portugal, the current governments campaigned against austerity. We have had political turmoil in southern Europe, but the crisis did not calm down until the famous London speech by Mario Draghi. What is the legacy of austerity policies?

I do not agree with that description. Spain, Portugal and France are clearly improving. So I don't think Southern Europe is in a difficult situation. To get out of the crisis the ECB monetary policy was important. But for me, the most important aspect of why we are out of the crisis is the following: The five countries that needed support from the ESM and the EFSF were prepared to implement reforms and adjustments, including the fiscal consolidation that was necessary. That was not a policy prescribed by Brussels or Frankfurt. It was a policy required to address and solve the problems that had accumulated in these countries in the previous decade. There was no way around that. It has been done successfully. And that is the most important reason why Europe is performing better today. In addition, the ECB was instrumental in turning market perceptions in 2012. And the creation of ESM helped as a lender of last resort for sovereigns. Without the ESM probably some countries would have been forced to leave the euro area. It is too narrow to say that only one statement did the trick. It was the result of the hard work of the countries and the institutional innovations, which will continue to be available in the Euro area that made it possible to get out of the crisis. I think that this analysis is very important. Because improvements in these countries are significant and lasting. That gives me

confidence for the future of monetary union. New institutions are here on a permanent basis and can be used again. All that indicates that we have made real progress in the monetary union. Our currency union is much more robust and much less vulnerable than 10 years ago.

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