Klaus Regling in interview with Público (Portugal)

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Interviews

Interview with Klaus Regling, ESM Managing Director
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Are you confident that European leaders can reach a meaningful agreement on euro area reform at the summit at the end of this month?

I think so, although in Europe, things always move in small steps. The summit in June is important, but it will not be the last summit on this topic. I hope the summit can reach some general conclusions on completing the banking union and on the future role of the ESM. But we will need some time to spell out the details. There will be more summits in the second half of the year, and I could imagine there will be a roadmap showing what remains to be done after the June summit, in order to have more precise agreements, maybe in December.

Do you see Angela Merkel's recent interview as a sign that she is getting closer to an agreement with Emmanuel Macron?

Yes, I think they are moving closer to each other. Germany and France are continuing to work together. There was a meeting between the two finance ministers last weekend. The two governments will meet on the 19th of June, with the main purpose of reaching a joint position for the June summit. I don't know what the outcome of that will be. But the two countries are very seriously trying to reach a common position, and this is very helpful. This has happened many times in the past: quite often Germany and France don't have the same position in the beginning. But then they work on it and come to an agreement. Of course, in the end, all other member states of the euro area have to agree as well.

Usually Europe advances most in moments of crisis. We are not in a moment of crisis now, so do you fear this opportunity for change might be lost?

It's true that, during a crisis, decision can be made very quickly. In more normal circumstances, decisions in Europe take some time, because we are dealing with 19 countries in the euro area and 28 countries in the EU. And all of these countries are independent sovereign nations, so to find a consensus is not easy. A crisis can accelerate such decisions. We saw that when the European Financial Stability Facility (EFSF) was set up in 2010 and the ESM in 2012. We also saw it with the Banking Union, and on the programmes for five countries. But of course, we are very happy that we are not in a crisis right now. And we can also make progress when we are not in a crisis. Our governments are trying very hard to come to an agreement. It's important to do so this year, because the economic situation is good. The important elections for the European Parliament next year, and the change in the European Commission, quite naturally will interrupt the process. So that's why it's important to come to some decisions now. And I think there's a good possibility that will happen.

You have argued for a fiscal capacity in the euro area. What Chancellor Merkel said about this is enough?

What is important is that we reach some understanding that a fiscal capacity is a useful addition to the instruments that are available in the monetary union. In that sense, the interview by Chancellor Merkel was important, because she mentioned one possible option. Other countries have different proposals, and it's important to bring these together. And that’s what's happening at these talks ahead of the summit.

Do we need a fiscal capacity only to help countries face crises, or also to bring about more convergence?

Both are possible, although one has to remember that we already have instruments that deal with convergence. There are transfers via the EU budget, which was always designed so that countries with income levels below the EU average are net recipients from the EU budget, and richer countries with incomes above the EU average are net contributors. So we do have a transfer mechanism. The only reason for that is to promote real convergence. So we do already have that instrument, it is not that we have to invent something completely new. What would be new is a facility for macroeconomic stabilization, and that might be more challenging to design and also to find unanimous agreement on. But it's on the agenda, and the interview by Chancellor Merkel was an important contribution to that debate.

Where do you see the banking union discussion heading at this moment? Angela Merkel chose not to talk about a common deposit insurance scheme, are you expecting decisions in this area?

I don't expect final decisions, but perhaps a declaration to do more work on the details. There are two elements to complete the banking union. One is the backstop for the Single Resolution Fund (SRF). There is almost a consensus that the ESM can provide that backstop. What has not yet been defined is when it could become operational. The other element is the common deposit insurance scheme, and that's still controversial particularly the timing of it. Most people would agree that now that we have common supervision, we also must have a common deposit insurance. But the controversy is about the conditions that have to be in place to make this possible. That includes the question of non-performing loans and of the amount of sovereign bonds on the balance sheets of banks, which are high in some countries.

Will it be possible to at least decide on a timeline?

It will not be easy, but it is possible. The question is how much progress we think is needed with those issues of non-performing loans and sovereign bonds - which to some extent are legacy issues from the crisis - before we can move to a common deposit insurance. That is the important point. It may take a while until we get to the common deposit insurance. But it is important to have a commitment that it will happen eventually.

It seems a consensus is building around the idea of a stronger ESM. What do you see the ESM doing in the future?

The ESM has come a long way already. Initially it was created to mobilize money, to issue bonds and find investors in the markets to finance the adjustment programmes. I think we have been doing that quite well. But now we are ready for other tasks. We are one of the institutions monitoring the Greek adjustment programme and we have done a debt sustainability analysis. Now euro area members think our role should be strengthened. One new role can be the backstop for the SRF. One can also imagine we would play a role if other instruments are created, such as for macroeconomic stabilization. Then, if there is the need for a new adjustment programme – I don’t see that any time soon, but one day there will be another crisis - then it seems likely that the European Commission and the ESM will be asked to manage such a situation together, and to design, negotiate and monitor it jointly. So in that sense the role of the ESM will also get stronger, and I think we are ready to do that.

It will get stronger but at the same time the ESM will become more visible for the public...

Well, first of all, the ESM would not do this alone. The people thinking about strengthening the role of the ESM, always also make clear that the ESM would act together with the European Commission. The European Commission has the competences and also the experience in many of the relevant areas. And we don't want to duplicate that. But otherwise you are right: with more mandates, the ESM will become more visible.

And what will the role of the IMF be?

We have to see how that will be managed in the future. The role of the IMF might become smaller than in the past, but the Fund will still be around. All the member states of the euro area are also members of the IMF. And Europe wants a strong IMF globally, particularly at a time that the US government is questioning multilateralism in general. In Europe, we do believe in multilateralism, and the IMF is at the centre of the international monetary system.

Do you think the ESM will be subject to less scrutiny than the IMF, because it is a European institution?

It is always a risk that an institution that recommends adjustments and reforms is not very popular. That's probably unavoidable. We provide money like the IMF does when a country loses market access. In order to regain market access, adjustments and reforms are necessary. That can be very painful. Of course, the measures that are recommended must be organized together with the government of the country. We must explain very well why certain measures are needed. But it might still be unavoidable that an institution that has that task is not very popular.

Sometimes in this discussion, the ESM is seen as the technical entity, as opposed to a more political European Commission.

A lot of the work of the Commission is also very technical. When I look at the last two years, the political decisions are taken by the Eurogroup of euro area finance ministers. The institutions prepare these decisions, and that's mainly technical work.

Do you see ESM having a role in checking if fiscal rules are being met by a country?

No, that's the role of the European Commission. And that role is given to the Commission in the EU Treaty. So it's only possible to change that if the Treaty gets changed, which is certainly not on the agenda for the next few years.

How important is it for the functioning of the ESM, which sometimes has to act with urgency, to bring an end to unanimous decision making?

Of course it’s always easier if decisions are taken by a majority, or a qualified majority. But I don't see the willingness of our member states to give up the unanimous decision making for the immediate future. That may change one day but for the immediate future I don't see it. At the same time, this has never been a problem during the last few years. In a crisis, everybody comes together and supports what needs to be done in the end.

There was a relatively modest reaction by the markets to the news of the new Italian government and its budgetary plans. Did you expect a stronger market reaction?

You have to understand that we have not seen the intentions of the new Italian government yet. Markets reacted to the programmes of the parties that form the new government. Now we have to wait and see what the government policies will be. We’ll hear that over the next few weeks.

Is the euro area ready to face a major crisis in Italy?

I don’t see the risk of a major crisis in Italy. But if it were to happen, the situation would be completely different compared to 2008. We have institutions such as the ESM and the banking union. The banks are much healthier, they have doubled their capital. The fundamentals of all countries are better today. There are no big fiscal deficits, no big current account deficits in countries that had lost competitiveness. On Italy, it’s best to wait and see what the government really intends to do.

But Europe hasn’t tested that new architecture with a crisis in a big country…

But we tested it with five countries at the same time, which is quite substantial. The institutions we have and the mechanisms are there for all countries.

Countries like Portugal and Spain suffered in terms of interest rates from the market reaction to Italy. Do you see more spillovers if the situation in Italy remains volatile?

It's true we saw some spillovers three weeks ago in Spain Portugal and Greece, but not so much. The reason is very clear: these countries are in much better shape than eight or ten years ago. So the risk of contagion is much smaller today than they were eight years ago. That is the positive result of the adjustments and reforms that we have implemented.

Is this a good environment for a successful return to markets by Greece?

Greece already returned to the markets last year, they issued bonds on three occasions. It has made good progress over the last two and a half years since the current programme began in September 2015. Of course, Greece is a very special case because they are in the eighth year of their adjustment process. Other countries, including Portugal, finished their programmes after three years. They went back to the markets and are now very successful. Greece can also become a success story, like the other countries, but it must continue with their reforms.

After eight difficult years, do you think that is possible?

They have come a long way. They eliminated their fiscal deficit and have been running a fiscal surplus since 2016. They will continue with that the next few years. So they have put their budget in order running surpluses, which not so many countries do in Europe. But they should continue to implement structural reforms to raise their potential growth rate. Markets are looking at all of that, and so I think Greece really has a chance to fully regain market access.

The markets are also expecting some kind of definitive agreement on debt relief.

That’s also on the agenda. For the short term, it is not so important, because Greece already received so much debt relief in 2012, and they're benefiting from that substantially. But in the longer run it is an issue, because we want to make Greece attractive for investment. Not only portfolio investors who buy Greek bonds again, but also for the real greenfield investment. It's important for Greece to create an environment that is growth friendly. That includes having taxes that are not too high, and a good regulatory environment. But the other side of the coin is to grant debt relief. And that's on the agenda of the next Eurogroup of the 21st of June. There's a commitment from the Eurogroup to provide more debt relief at the end of the program if it is needed, and if Greece has met all the programme conditions.

Were you surprised by the sudden change in the Portuguese economic and fiscal results in the last few years?

For me it was not a sudden change. I have always believed that the adjustment programmes in Portugal, Spain, Ireland, Cyprus and Greece, would work. When I worked at the IMF, I had the experience that these adjustment programmes can be very painful in the beginning, but they show positive results after a while. The programmes in Europe, including in Portugal, were tough. But the problems that led to the crisis were tackled, and so I'm not surprised to see positive results.

That's not what the Portuguese government has been saying about the adjustment programme. For the government, the programme was not essential for the recovery and it wants to put less of a focus on austerity.

I don't think there's a big disagreement. The fact that the situation is better now means there's less need for fiscal adjustment in the future. But some of the measures taken during the programme help to explain the good growth performance now, like the improvement in competitiveness and the reductions of the fiscal deficit. These were important conditions to improve the economic situation.

What do you think of the present fiscal and economic policy pursued by the government?

It's very good that the government uses these good economic times to consolidate the budget, because the debt level in Portugal is high. That makes Portugal vulnerable. Bringing down the fiscal deficit is the best way to reduce debt levels over time and to be prepared for the next crisis. I don’t see that coming any time soon, but one day there will be a crisis again. And countries with low debt levels have less of a chance of being attacked by the market.

Portugal should be doing even more?

Well, if the deficit is brought below one percent of GDP this year, I think that's an important step. But then over time that should not be the end of the story. The objective is to run a small surplus in good times such as the ones we are seeing now.

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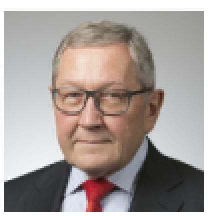

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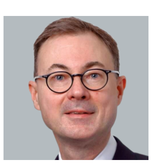

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