European Stability Mechanism

Annotated transcript of ESM Managing Director Klaus Regling's interview with Peter Spiegel of the Financial Times, as published by the FT Brussels Blog, 02/10/2015

Peter Spiegel: So were Regling and IMF chief Christine Lagarde at cross purposes? Regling argued it was not the case, but simply a different timescale for looking at Greek debt, with the IMF looking to be repaid within ten years while the ESM was able to consider a much longer time horizon.

Klaus Regling: I don't like to construct here a fight between the ESM and the IMF, it doesn't exist – and certainly not between me and Christine Lagarde. Initially, it was very simple: the IMF has its traditional model of debt sustainability, how they measure it. They do it to some extent because they want to be sure they get their money back, which is in everybody's interest because they're the preferred creditor, they are the global international institution. They have practices for decades, and they want their money back after ten years. That's why they focus on a ten-year horizon.

Initially, that even worked for the countries that borrowed from the EFSF, because initially our maturities were also ten to 15 years. So that's why initially this was also ok for us. But then as we developed our systems, and we developed them by reducing our interest rates repeatedly – initially there were margins. That was reduced because the focus became clearer that we wanted to help countries to reach debt sustainability over time. Because the problems were huge in some countries – particularly in Greece, but also in others – that's why maturities were extended: 22 years in Ireland and Portugal, 32 years in the case of Greece.

With these long maturities at these very low interest rates…all of a sudden this traditional IMF concept, which is fine for the rest of the word, didn't fit any more. We had taken a longer time horizon. We also want countries to be sustainable, so the objective is the same, but our time horizon is much longer. The construction of the EFSF and ESM allowed us to take that longer time horizon, with lower interest rates – we charge much less than the IMF – and therefore we had to change the approach.

The traditional IMF approach – and I'm not criticising it for countries outside Europe, and it was fine even for us initially – was no longer fit for purpose. Our framework has changed dramatically, and the world has never seen a framework like that. We are providing so much solidarity to the borrowing countries, who in exchange have to do very dramatic adjustments, that also we have to change the way we look at debt sustainability. That was the starting point.

PS: At the centre of Regling's argument is what's known in economics as "stocks" vs "flows". The IMF has traditionally looked at overall debt stock – the total debt a country has as a ratio of gross domestic product. Regling's argument is that stocks are almost irrelevant when you consider that Greece is not actually paying all that much on an annual basis to service that stock. The annual "flow" is below what almost all Eurozone countries are currently paying, as a per cent of GDP.

Still, the IMF reports showed that they had done considerable amount of thinking about how to return Greek debts to levels where Athens will be able to pay it down on its own without the need for bailout financing. Had the ESM done similar work ahead of another round of debt relief talks, which are expected to come later this year?

KR: We have a duty to think about it, because today we have 45 per cent of all Greek public debt. If this third, most recent programme is fully disbursed we will have more than 60 per cent of all Greek public debt. So we must think about all these issues. We also want Greece to return to debt sustainability, like the IMF, but we I think understand that if the time frame is different, the concept has to be different. This is why we developed this approach of looking at the annual debt-service burden, so more the "flow concept" instead of the very simple "stock concept".

I'm not saying we have a conflict here, but I think we had that duty to develop something that fits our framework better.

PS: Did Regling think the IMF was moving in his direction on the debate?

KR: They've said it publicly.

PS: One of the arguments made by advocates of debt relief is that private investors are spooked by a large "debt overhang". Why would they lend to Greece if most Greek debt is held by bailout lenders, who are by definition senior to private bondholders? Regling disagreed that this was an issue, and pointed to the fact that in 2014, private investors began buying up both Greek sovereign debt again, as well as debt issued by Greece's banks.

KR: What we saw last year happening, before the elections in January and the new government, Greece in 2014 had growth for the first time. Investment was coming back. There was a lot of investment in Greek banks, billions and billions. The Greek government was able to issue bonds last year. I know from my talks with investors, which is still my main job, how they look at it. They see very clearly there is no debt overhang, certainly not the next decade.

Today, I wouldn't expect investors to go into Greece and look beyond ten years. They will look for a few years. They came to the conclusion last year that this is doable without too big a risk. I think it confirms what I said earlier: They don't look at the debt-to-GDP ratio, which is very high. They look at: how big is the risk that I will not be repaid? That is very low, because the annual flow is so small. We know it's smaller than in quite a number of European countries. The actual annual payments out of the budget are lower than Belgium, Spain and several other countries. This concept of debt overhang doesn't work like it used to work.

PS: Some economists argue this misses the point, though. Financial investors, like those who purchase bonds, may have a time horizon shorter than ten years. But investors in the real economy – those who provide the kind of foreign direct investment needed to see local enterprises grow – have much longer time horizons. And those with experience with third-word debt issues argue that big sovereign debt restructurings a frequently a precursor to private investment in the real economy. Did Regling worry about that?

KR: I think it's a question of information. They [longer-term investors] should come to the same conclusion. Why do they look at debt overhang? They are worried that some day there will be another problem and they will not be repaid. In that sense, investors in the real economy are not that different. They may have a longer time horizon, that's true. But what is more important here is that the programme agreed with Greece is implemented because that will remove many of the impediments to foreign investment.

PS: Regling seemed to be arguing that Greece actually didn't need any debt relief at all. As an aside, he noted that Athens had benefited from the most concessionary lending terms "in world history". Was he arguing that no debt restructuring was called for?

KR: You know the commitment of the Eurogroup. We will look at the debt situation. There is the possibility of additional debt relief — if needed, that's what the agreement says. And if Greece implements the programme. And that's what we will do. But not a nominal haircut, and based on my analysis a nominal haircut is not needed.

PS: The discussion then turned to Regling's role in the upcoming negotiations. Although he remains a civil servant, and the decision will ultimately be made by politicians, his arguments appeared to have carried the day in the past. Did he anticipate playing a central role in the next round of debt talks?

KR: We have to give our input, because that's needed for doing forecasts on the budget, on debt sustainability. We give input. We need the information to prepare ourselves for our lending activities. That's our role. Given that we have been thinking about debt sustainability in this new context that we have created, this new framework, we also provide some analysis of what is useful, what is needed. Of course, we are not the one who decides. We discuss it with the other institutions, but in the end the Eurogroup decides.

PS: If Regling didn't think there was a significant difference between the ESM and the IMF on the issue of debt, what about between the ESM and the Greek government? For months, particularly while Yanis Varoufakis was finance minister, debt relief appeared to be the central demand made by the Syriza-led government in Athens.

KR: I think now there's a big convergence. The Greek government realises there will be no nomial haircut – and for good reasons. The Greek government should sell what has happened already – and what might have been – very positively to their electorate, to the Greek population, because the benefits are there in any case. In the end, it doesn't matter if you pay high interest rates on a low debt stock or low interest rates on a high debt stock, the economic impact on the budget and the economy is the same.

In our system, it's easier to do what we have been doing. The benefit has been enormous.

PS: Regling recalled a press conference he had with Varoufakis' predecessor as finance minister, Gikas Hardouvelis, where Regling repeated his argument that the concessionary rates being given to Athens through the Eurozone bailouts is saving Greece €8bn every year, compared to the rates it could have achieved by borrowing in the public markets.

KR: Our calculation is €8bn in savings every year. He [Hardouvelis] immediately said: this means every Greek household saves €3,000. I think one should explain that to the Greek public. This is what has already happened so far, and that's what should count.

I see a broad convergence in this direction from the Greek side, from the IMF, so I don't see a big controversy.

PS: Clearly not everyone agrees with that. Among the most prominent was Varoufakiis himself. What did he make of Varoufakis' arguments on the need for debt relief?

KR: He had so many strange ideas, I don't think I want to comment on any details. You can quote me on that…. I think he dislikes many people he has met in Brussels. There are not many left who like him, and therefore he dislikes them.

PS: But Varoufakis is not alone. Many US-based economists, including Joseph Stiglitz, Paul Krugman and Jeff Sachs, have argued that debt relief is needed, too.

KR: Some of these famous American professors just have very different ideas from mainstream Europe. They always want larger deficits, more government expenditures, and we don't believe in that. We have the experience that this is not necessarily helpful, that high debt levels can lead to problems.

Of course, there are situations like in 2008 and 2009, where even the Stability and Growth Pact [the EU's budget rules] allowed [countries] to go beyond the 3 per cent [deficit] limit. So we have a framework that can accommodate very special situations, and the global financial crisis when it hit was such a special situation. There was a collective decision to increase deficits and take fiscal stimulus measures. And that was absolutely right.

But now, six years after the crisis, to continue to preach to everybody – also to the US government, it's not only us, so at least they are consistent, they always preach under all circumstances to spend more money. **I don't think we in Europe want to take that advice so much.**

When they talk about the need for nominal haircuts, I invite them to come and look at our numbers. I had a number of discussions, serious discussions, with other academics, who accept my arguments.

PS: The IMF's analysis was then presented to Regling. In their documents, they argued at first for extending the repayment period for Greece's Eurozone bailout loans to 40 years, including a 20-year grace period where no interest payments would be made. In the an updated analysis in July, made after it was clear Greece's economy was going to be worse off following the shuttering of its banking sector, they argued for 30 year grace periods. Were those figures realistic?

KR: I will not talk about details, because we are in the middle of this work. It seems to me a little on the long side. One can look at that, but it seems to be unneeded to be that long-term. And many variables change all the time, including the assumptions about growth, which of course is a function of how quickly reform programmes are implemented. Some of this is probably already outdated again.

Global interest levels play a big role. That's something people often forget when they say: this year everything [in Greece] must look worse than a year ago. What they forget is that the yield curves this year are much lower than they were a year ago, and that leads to substantial savings.

There are many variables that have an impact on this kind of judgement and we will have to look later in the year where we are.

PS: Some in Germany have argued that maturity extensions and grace periods of the kind the IMF was advocating was, in essence, a "haircut" through the back door, since the terms would be so concessionary that Eurozone creditors were in fact accepting losses on their loans. Was that a possibility?

KR: No, we wouldn't do that. Nobody has suggested that. What we do in our system is very clear: we charge our own funding cost. Our funding costs are low, because on the EFSF side the six strongest member states guarantee, through guarantees, the operation of the EFSF. For the ESM we have the paid-in capital, €80bn, and big amount of callable capital. That's why we have a very strong rating. That's why our funding costs are low. That's why the benefit for the receiving countries is so big. But there's no loss for anybody.

Of course risks are assumed, and occasionally risks can materialise, and then there would be a cost. But so far…we have never had a loss. This concept of lending long term at low interest rates, with grace periods, is a big help for Greece and the other countries and there's no cost to the taxpayer, but the taxpayer assumes risk.

We charge our lending cost. The interest deferral leads to a higher stock of outstanding debt, because it's added to the outstanding debt. But the money is not lost.

PS: Although the debt relief debate ran hot over the course of this year's bailout negotiations, it's hardly the first time this issue has caused problems. Back in late 2012, the IMF and Eurozone finance ministers had [a similar dust up], with the IMF backing significant losses for Eurozone governments and the Eurogroup – then headed by Jean-Claude Juncker – resisting. This led to another one of the Eurozone's periodic periods of almost weekly crisis meetings, including one in which [Juncker openly admitted] he and Lagarde were not seeing eye-to-eye. Could this round be tougher than the 2012 dispute?

KR: It should be easier. It's never painless, because it does mean taking on risks for longer if there's a move. Not all member states are happy about that, because these are risks. There are no immediate direct costs, but there are risks and with the longer maturities it means the risks stay longer with our member states. So nobody's taking this lightly, and therefore there will be a serious discussion.

This new government in Greece has just been formed a week ago. What I hear from [Alexis] Tsipras [Greece's re-elected prime minister] and his statements during the election campaign and in parliament sounds much more reasonable than what he said a few months ago. Therefore I would expect less controversy, but we will see. It's good to prepare everything. It's never easy because the amount of money is huge. Risks are there.

We are really waiting for better implementation on the Greek side of the programme. That's the precondition anyway. I think it's in the interests of the Greek economy to do it, and in the end debt sustainability will only come with long lending maturities, of course, at low interest rates. But what is certainly and definitely needed to bring it all together is that the reforms are implemented to strengthen the growth potential. Otherwise it will not add up.

PS: Regling, like other Eurozone officials, has regularly pointed to Ireland, Portugal, Spain and, more recently, Cyprus to argue that its bailout policies worked. Was Greece a unique case in which creditors repeated attempts to impose economic reforms were just doomed to failure, since successive Greek governments seemed unable to implement the overhauls demanded by Brussels?

KR: The deficit last year was about 20% of what it was five years ago. Don't say they haven't done anything, even on structural reforms. The OECD and the World Bank tried to do something that wasn't easy. They tried to rank their members according to the progress in structural reform implementation. This is difficult, because you have to add apples and pears. How can you add labour market reforms with opening of professions? But they tried to do it, and if somebody can do it, it's the OECD. And they put Greeceas number 1 of all their member states as far as the implementation of structural reforms is concerned. Something happened, otherwise the OECD would lose all credibility.

The World Bank publishes every year a survey on the ease of doing business in countries. In 2011 Greece was ranked 109 and by 2015 the country had advanced to position 61.

That really shows the progress and one should really give Greece credit for that. But it also sows at 61st place, Greece is the weakest country in the EU. This explains quite well what has happened and what still needs to be done. But I think to only talk about what still needs to be done is difficult to digest for a society that already has gone through so much.

PS: But even many Greeks argue that its public administration is so ineffective that it is nearly impossible for the bureaucracy to carry out the reforms – even if parliament passes them into law. Did he agree with that analysis?

KR: There are many problems. That's why they are in place 61. It's a weak administration, a weak tax administration everywhere, which reduces the implementation capacity and ability. These are typical phenomena of low-income countries, otherwise they would have higher productivity levels and higher incomes. The problem was, the crisis developed because they tried to push up income levels to northern Europe without having the productivity level to support it. The weak administration is a reflection of that, it's the basis of that problem.

PS: Regling sounded optimistic that, even with the administrative difficulties, Greece could still be reformed and joint its Eurozone bailout brethren on the course of growth. But what about the politics? After five years of austerity and hardship – and increasing resentment in some countries providing the bailout loans – wasn't it becoming almost impossible for their to be political support for the Eurozone's current approach?

KR: Of course there's reform fatigue after a number a years, and there's also support fatigue after a number of years. But it's not what we see happening in Europe. We had changes in governments in Ireland and Portugal in the middle of the programme and the new governments continued to implement the programmes.

I think Greece is also an example. The population wanted to stay in the euro even if it means more painful reforms. All the surveys are very clear on that, and that's what Mr Tsipras promised in the second election campaign, to implement the reforms – and he was elected. So I don't think one can generalize and say governments fall after two years. That doesn't work any more. It's just not what we see in Europe.

It's never easy, and the other point is that when so many things need to happen – like in Greece, but also in some of the other countries – the purpose of having us, the EFSF or ESM, like having the IMF globally, is to spread out the time that is available for reforms and adjustment. Without the IMF, without us, what would have happened in many cases, like the Asian crisis or Latin American debt crisis, when countries lose market access, and at that point in time they typically have large deficits, overnight they need to reduce expenditures to their revenues. That's the brutal adjustment we want to avoid. The purpose of creating the IMF, creating the EFSF and ESM, is to allow the spreading out of reforms.

PS: That sounded a bit ahistoical, given what had happened in the first half of the year. Didn't he think things had become more contentious politically than even 2011 or 2012, the last time Greece appeared on the brink of Grexit?

KR: I remember quite vividly it was not easy to get things going in 2011 and 2012. Creating the EFSF, the ESM. You know in Germany, for instance, there were cases brought to the constitutional point. It was never easy.

What was new is that everybody was fed up with what Mr Varoufakis told us in these meetings during the first half of the year. There was indeed no patience any longer, because the deal we thought we always had was very clear: there can be money available, there can be financial support, but only if the country implements reforms. But that was falling apart. It was breaking down. That's why everyone was exhausted and fed up.

So we needed this change in Greece, or it would have come to a halt, the support programme. And that's quite logical. That's the way we're set up, that's the way the IMF operates. There can be support, financial support…but the country also has to deliver. It has to come from both sides. We had evidence things were moving backwards in Greece. Many measures were reversed. That's why it's not at all surprising that many, many countries – not only the Eastern Europeans – got quite upset. I got upset.

PS: Regling is not alone in pinning a lot of the blame on Varoufakis. But by June and July, many Eurozone officials – including Jeroen Dijsselbloem, the Dutch finance minister who chairs the Eurogroup – were publicly raising questions about Tsipras himself and whether his government could be trusted to implement any bailout reform agreement. Was the removal of Varoufakis as finance minister, and the political implosion of the far left wing of Syriza – which split from the party but then failed to gain any seats in parliament – enough to make Tsipras trustworthy again?

KR: Mr Tsipras is clearly very different from Mr Varoufakis because he signed the agreement at the summit in July. The new finance minister, Mr Tsakalotos, signed the Eurogroup statement. They went to the election campaign promising to implement this programme. That's completely different from the rhetoric before.

There was a loss of trust in the first half of the year. We're happy the programme was signed, that the new government ran with that programme. In that sense, the election was really very important, in my view. Mr Tsipras is still Mr Tsipras, but in February when he started his first government, he had no mandate to implement these kinds of reforms. He had the opposite mandate. That's why these problems came up. Now he has a clear mandate to implement the agreed reforms. That's good, much appreciated. But the first review will really be then a confirmation that this building up trust continues and is justified.

If the conditionality is not accepted, if the agreed reforms are not implemented, there will be no next disbursement.

PS: That means there's a lot riding on the first quarterly review of the bailout programme, both in terms of whether the IMF will ultimately join in the third rescue and whether Greece's performance is adequate to begin the debt relief talks. Are the stakes big enough that Grexit could come back into the deliberations?

KR: I don't assume so, because Mr Tsipras during the election campaign, in his statements in parliament since then, also the finance minister who has been in office now for three months, they don't question the implementation of the programme. We know, and this is really encouraging, that 70 per cent to 80 per cent of the population are behind it. They want to stay in the euro area, they know it means additional reforms, and this is by the broad majority of the population not questioned.

PS: We returned to the role of the IMF, particularly the issue of whether they will contribute to the €86bn Greece now needs over the next three years. If the IMF doesn't participate, the ESM would likely have to lend the entire amount – minus any extra privatisation funds Greece can raise and money it may be able to raise in the bond market once it's back on stable ground. Did Regling think the ESM would have to shoulder most or all of the €86bn?

KR: The credit agreement we have, and also the MoU, talks about a programme of up to €86bn. So in principle, and that's also what parliaments approved, that's written down. That's more than an assumption.

But for my internal purposes, because we have to think about raising money – that's our core business, we have to think about liquidity, asset/liability management – for internal purposes we assume the ESM will not finance €86bn over the next three years, but substantially less. I assume the IMF will come in, we don't know the amount. Privatisation receipts will hopefully help. My assumption is that with full programme implementation, there will be market access well before the end of the programme.

They have a good chance later next year [to go to the capital markets], with the assumption the programme is implemented, and if its not implemented we will not disburse. I think it's a good valid assumption. Therefore, I don't think the ESM needs to disburse much more than €50bn to €60bn. But the commitment is there from the Eurogroup, I'm not questioning that, of course. But for our own planning purposes, we assume it will be a bit less.

PS: The messages coming out of the IMF have occasionally been a bit mixed. Its debt sustainability reports paint a picture of a very hardline Fund reluctant to jump back into Greece without huge debt relief, and the European Commission has warned Eurozone governments that the IMF – burned by Greece earlier this year, when it became the first developed country ever to default on IMF loans – may need to see a prolonged period of Greek good behaviour before deciding to participate again. At the same time, senior EU officials have said they have been reassured by Lagarde that the IMF will ultimately play ball. How certain was Regling that the IMF would be there, in the end?

KR: It's a big institution so I'm not surprised there may be differing views. What counts for me is what Mme Lagarde said in the Eurogroup, and most people assume the IMF will be there. That they'll look at implementation and the first review, that's very understandable, but I think, I can only hope they'll continue to be there.

Some of these arguments that come out of the IMF board sometimes that the IMF is too active in Europe these last five years, I find a bit strange. This is what happens in a regional crisis. During the Latin American crisis, the IMF was almost exclusively providing loans to Latin America; during the Asian crisis it was almost exclusively to Asian countries. Which is normal. When there's a regional crisis, the IMF is the global crisis fighter, so it should be there. For the last five years, it was mainly Europe.

We also know some of the executive directors from emerging economies were even corrected by their own finance ministers. Maybe this was also going a little bit too far by certain persons.

PS: Did he have any idea how much of the €86bn the IMF would actually contribute? The Fund ended its second bailout programme having failed to distribute €16bn it had originally committed to Athens. Was that likely to be the new total?

KR: I don't know what the number will be. The leftover [from the second Greece programme] was €16bn, so that's one reason some people think it could be €16bn, but I have not seen anything officially from the Fund.

The IMF money helped to reduce the need on the European side. Initially, the IMF gave one-third and the Europeans gave two-thirds [of bailout funding in Eurozone rescues]. Now it's more one-tenth to nine-tenths because our capacity has grown over time.