από κ. Χαρδούβελη

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Transcript: Lorenzo Bini Smaghi

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The FT spoke with Lorenzo Bini Smaghi, ECB executive board member, on May 27 in Frankfurt

Financial Times: Euro area membership was based on obeying fiscal rules. Surely those who break the rules should pay the price – even if that means defaulting or exiting the euro area?

Mr Bini Smaghi: You are correct that those who do not respect the rules should be punished, and this is what happens when countries agree to follow an IMF/EU adjustment programme. They have to adopt measures – fiscal and structural – which reverse their previous mistakes.

A debt restructuring, or exiting the euro, would be like the death penalty – which we have abolished in the European Union. On top of that drastic measures such as a default or restructuring would produce contagion effects in other countries and affect taxpayers in the other countries. Why should they pay for the mistakes of others?

FT Some argue that a Greek default would be the least worst-option for the euro area. The impact on the euro area would be containable and it would reinforce euro area principles long term. Why are they wrong?

LBS It would not be the least worst option - as we can see from the reaction of financial markets, not only within the euro area but also outside. The destabilizing effect could be quite dramatic. Those who say that the impact would be contained simply do not look at the data. It reminds me of those who in mid-September 2008 were saying that the markets had been fully prepared for the failure of Lehman Brothers.

All sophisticated indicators of systemic risk, cross correlations of CDS and yield spreads show a high sensitivity to restructuring moves and are at levels higher than in September 2008. Suggesting that there are no contagion risks is naοve and entails taking a risk that no responsible policy maker can afford, if he or she has any interest in the well being of its citizens.

In addition, default or restructuring would not help solve the problems of the Greek economy, problems that can be solved only by adopting the kind of structural reforms and fiscal adjustment measures included in the programme. On the contrary it would push Greece into a major economic and social depression.

FT Otmar Issing, your former colleague, says Greece is insolvent and it “will not be physically possible” for it to repay its debts. Is he right?

LBS He is wrong because Greece is solvent if it applies the programme. They have assets that they can sell and reduce their debt and they have the instruments to change their tax and expenditure systems to reduce the debt. This is the assessment of the IMF, it is the assessment of the European Commission.

Poor developing countries have no assets, their income is low, and so they become insolvent easily. If you look at the balance sheet of Greece, it is not insolvent.

The key problem is political will on the part of the government and parliament. Privatisation proceeds of €50bn, which is being talked about – some mention more - would reduce the peak debt to GDP ratio from 160 per cent to about 140 per cent or 135 per cent and this could be reduced further.

FT Mr Issing also said Greece should never have been allowed to join the euro?

LBS It is not a very useful statement at this point.

FT Why would it not be possible to organize a so-called "orderly" debt restructuring as suggested by prominent economists, for instance, Nouriel Roubini and Deutsche Bank's Thomas Mayer? Have we not learnt from the experience of Latin American countries?

LBS It is a fairy tale because it tries to apply the Latin American experience of the 1980s to the current Greek situation, which is totally different, in many respects.

First, the Brady bonds solution was a solution for American banks, which were basically allowed not to "mark to market" the restructured bonds. There was regulatory forbearance, which was possible in the 1980 but would not be possible today.

Second, the Latin American crisis was a foreign debt crisis. The main problem in the Greek crisis is Greece, its banks and its own financial system. Latin America had borrowed in dollars and the lines of credit were mainly with foreigners. Here, a large part of the debt is with Greeks. If Greece defaulted, the Greek banking system would collapse. It would then need a huge recapitalization - but where would the money come from?

Third, after default the Latin American countries still had a central bank that could print money to pay for civil servants' wages, pensions. They did this and created inflation. So they got out [of the crisis] through inflation, depreciation and so forth. In Greece you would not have a central bank that could finance the government, and it would have to partly shut down some of its operations, like the health system.

Finally, in Latin America they imposed capital controls to partly expropriate the wealth of their own citizens to repay debt. This cannot be done in the EU. You have free flows of capital, free flows of people. This would make it much more difficult for the government to expropriate private wealth to pay debt.

So the situation is totally different. There is no such thing as an "orderly" debt restructuring in the current circumstances. It would be a mess. And I haven't mentioned contagion – which would come on top.

If you look at financial markets, every time there is mention of word like restructuring or "soft restructuring," they go crazy – which proves that this could not happen in an orderly way, in this environment at least.

Restructuring can be orderly, or even beneficial for investment banks and lawyers, but not for the Greek people. It would entail a major economic, social and even humanitarian disaster, within Europe. Orderly implies things go smoothly, but if you wipe out the banking system, how can it be smooth?

FT So the ECB has looked at various scenarios?

LBS Yes, and that is our conclusion.

FT Might a voluntary extension of debt maturities work?

LBS Let's assume that you have a Greek bond which expires in six months. It is valued at 90 per cent and you are hoping that there will be no restructuring and you will get your money back. Then the Greek government comes to you and says 'what about extending this for another ten years, at the same face value and interest rates?' Would you accept? If you are a rational agent, you would probably say No. But you might be induced to accept if the government would tell you that unless you accept the next offer will be a 50 per cent haircut – it would threaten you. Then it is not voluntary but a forced restructuring, which would trigger a series of credit events, CDS payments, so it is in all respects a restructuring. So "soft restructurings" "re-profilings" do not exist. They are catchwords that politicians have tried to use, but without any content.

FT But if the politicians do come up with something, what right does the ECB have to block it?

LBS We're not blocking – we're saying that it will not work. There is no difference between soft restructuring and restructuring, the impact will be the same. Then we will be a situation in which we will not be able to accept the relevant collateral.

FT ECB collateral policy has proved flexible over the past few years. Could it also not prove flexible in the case of a debt restructuring by a euro area member state? You already accept Greek assets given "junk" status by rating agencies.

LBS But this was conditional on the country following the IMF/EU programme. We made an exception to the minimum requirement because the country was signing up to an IMF/EU programme and sticking to it. This programme had public money behind it.

FT Is the ECB conflicted over Greece because you own €45bn of Greek government bonds and would therefore take big losses in a default?

LBS I do not accept this argument of a conflict of interest.

First, we at the ECB would only see 8 per cent of the impact on the SMP portfolio – the rest would be borne by national central banks, according to our rules. Make all the calculations you want – we are well protected. It is not an issue for us.

Second, if such an event would have an impact on national central banks – it would affect taxpayers. I think it is an act of responsibility to care about taxpayers' money when you talk about restructuring. People think that restructuring is a way to make the private sector pay and avoid taxpayers compensating them. But in the event of a restructuring, taxpayers of the other euro area countries will pay. We care about taxpayers' money and this is why we warn against restructuring. We seem to be the only ones.

Third, even if we had a conflict of interest at least ours is transparent. I would like all the investment banks, economists and lawyers who advocate a restructuring of Greece to also reveal the position of their own banks with respect to Greece. This is the real conflict of interest.

Finally, our position is a position based on principle, not a conflict of interest. In the euro area debts have to be repaid and countries have to be solvent. That has to the principle of a market based economy. The task of other countries is to make sure that they are solvent – that was the contract of the Stability and Growth Pact. If any country breach rules, the others should force them back to the rules with sanctions and so forth. It is totally crazy to create incentives for governments not to pay their debts.

FT It is a matter of trust?

LBS It is the basis of a market-based economy and confidence. How can people invest in the euro area, which is the second largest economy in the world, if they are told 'we are not sure if you will get your money back'? What kind of advertisement is it for the euro if we tell people 'you can come and invest but we are encouraging restructuring'?

I do not know any central bank in the advanced world which would advise its government to default or restructure.

FT Is it not bluff by the ECB? If Greece defaulted would you really pull the plug on its banking system?

LBS It would be the default that produced the collapse of the banking system. Greek banks hold Greek government bonds, the other assets they own are partly guaranteed by the Greek government. If there is no state any more, the financial system collapses. We cannot finance the state because there is a prohibition on monetary financing in the Treaty. We have to lend to sound counterparties and against adequate collateral.

FT Could the ECB's balance sheet withstand a default by Greece? What if Ireland and Portugal defaulted too?

LBS Again, the total Securities Market Programme is around €77bn. Our share is 8 per cent, which is a bit more than €6bn. It's less than our risk provision.

FT Banks in Greece, Ireland and Portugal have more than €200bn outstanding from ECB refinancing operations. That means you are perhaps holding €250bn in collateral from those banks. Are the risks of holding such assets not excessive for the ECB – and ultimately euro area taxpayers who might have to recapitalize the ECB?

LBS The eurosystem [of euro area national central banks] has lent to banks in Greece, Ireland and Portugal based on the fact that these three countries are under an IMF/EU programme and incidentally receive financial assistance through these programmes. These programmes have been designed and agreed because these countries are considered solvent. This is the reason why we consider absurd to talk about debt restructuring. We expect the debts to be paid and the banks in these countries to be sound, as long as the implementation of the programme is on track.

FT Are the risks you face in your open market operations are the real reason why you oppose debt rescheduling so strongly?

LBS The risk would be mainly on the central bank of the country that defaulted because the banks would be defaulting there.

Greece will not be able to return to financial markets in 2012 as planned. How much extra financing will it need – and where will it come from?

LBS Work is being done at present on how to fill the financing gap, which for 2012-13 should be around €60bn or €70bn. But on a very preliminary basis I could imagine a 50-50 distribution between official and private contributions, with the official part being one-third IMF and two-thirds Euro area countries. For the private component it would entail partly of privatizations and securitizations, some roll-over of positions in particular by Greek banks and some short term issuance. This has to be studied further, but the key element is the conditionality based on a strong frontloaded programme with concrete measures.

FT So you are talking about euro area countries coming up with another €20bn?

LBS Yes, which if you consider the share of the other 16 countries, would not be enormous. All this is conditional on the Greek government doing what it has to do, which is a new programme in which measures are specified, the privatization process is put clearly on track and delivers the €50bn within the next three to five years. If this is done then you have a major turnaround in the Greek economy and you are getting a primary budget surplus as from next year. Maybe the markets will start to think slowly that Greece can make it. That is how IMF programmes work.

If the Greek government agrees to the programme, the IMF will disburse and I am convinced that the euro area countries will disburse their part.

FT So the next tranche will be paid because the euro area governments will have a financing plan for 2012-2013?

LBS Yes. If the Greeks have proved in a convincing way that the programme is back on track – that it can cover the next two years, if there are sufficient privatizations, and so forth – then the IMF can disburse and the Europeans will do their share. But the key lies in Athens, not elsewhere. The key element for the return of Greece to the market is to stop discussions about restructuring. Because who would want to invest in Greece if these discussions about restructuring is going back and forth all the time?

Talk of restructuring by some euro area politicians over the last few months has been very damaging, as it induced market participants to believe that investing in the euro area is unsafe. Spreads increased dramatically as a result, increasing volatility.

The same politicians now suggest that they are against restructuring, at least until 2013. It really doesn't help because markets are forward looking, and saying that there will be no restructuring before 2013 suggests that there might be one after, which certainly contributes to scaring markets. It's against the principle of private sector involvement.

FT Do you think euro area politicians are acting "up to their responsibilities" in handling the Greece crisis – or more broadly, the issues confronting the euro area?

LBS It is the people who should decide – not me.

FT Has the ECB's securities markets programme failed? Was it a mistake?

LBS At the time when we intervened [May 2010] we succeeded - it contributed to avoiding a panic and certainly towards ensuring smoother markets. Of course, at times other events went in the opposite direction and the biggest thing that went against us was the talk about restructuring, which partly destroyed what we had achieved.

FT Will you continue "full allotment" in ECB refinancing operations beyond July – including for three months LTROs?

LBS It is too early to say. I am not sure if we will have sufficient data to take a decision in June.

FT Commodity price inflation now seems less of a threat than it was when you raised interest rates in April. Has this weakened the case for further interest rate rises?

We have never really reacted to short term developments. We have a medium term orientation. It maybe that we have seen some adjustments in commodity prices. But if you look over the medium term, keeping in mind the recovery in the economy, the very low level of interest rates that we have does not seem fully justified. A process of adjustment is required if the economy continues to grow.

FT On a personal note, some politicians have said that when Mario Draghi becomes ECB president in November, there will be "too many Italians" on the ECB executive board. Will you step down to allow somebody of a different nationality to take your place?

LBS I will not comment on that.