

2011-01-27- Lorenzo Bini Smaghi - RTE interview

Question: So first question I'd like to ask you is in Ireland there's been a perception at least that the bailout has had more to do with protecting the European financial system than assisting a euro member country that finds itself in trouble. What would you say to people in Ireland who say that the terms of the bailout deal done for Ireland are unfair?

Smaghi: First I don't like the word bailout, if I can say this. This is a support program for Ireland. It's an investment program. And these terms are defined by the IMF, so there is a long history about, for instance, the surcharge or the interest rate, the kind of conditionality attached to it in terms of fiscal adjustment. So I would say these are more or less standard terms which are applied to other countries also.

Question: But the terms applied by the IMF are slightly different to the terms that are being imposed as part of the European Financial Stability Mechanism, which is something that is a new procedure.

Smaghi: Yes. But European financial stability has been designed on the model of the IMF. So I would say that they are more or less comparable. So I think that in line with the experience of the IMF, what is important is to establish a track record in the adjustment program.

Question: But are you not concerned at the rate of interest that's being applied as part of the bailout could pose the danger that Ireland might indeed have to restructure its debts in the future, that the rate of interest is going to be higher than any nominal rate of growth the Irish economy might experience over the coming years.

Smaghi: Again, there is a long experience, more than 40 years, of IMF assistance. And typically if the country's successful in the first year of the adjustment then the terms can be changed. The maturities can be lengthened and, in line with this, many other things make it easier. And the vast majority of IMF programs I've led have been successful. Only a very few number, very little number of very poor countries have not made it. So I think Ireland can make it, like everybody else, like a big majority of countries. And if it is successful in the adjustment then things can develop in a way to make it sustainable.

Question: Are you suggesting that after a period of time, possibly a year, if Ireland is successful that the rates can be adjusted in some way?

Smaghi: No, there are standard procedures again in the IMF. These things take place after a journey of two or three years, after the normal standby agreement, in line with the conditionality. So if the program is on track and so forth, there are procedures to lengthen the maturities and to adjust the interest rates.

Question: Now I know you won't want to comment on the Irish political situation, but we have an election coming up. It hasn't been called yet. But opposition parties in Ireland are saying that they would like to renegotiate the terms of the bailout deal. Is there any room for any renegotiation of the terms and conditions of the deal done for Ireland?

Smaghi: But again, I think here we have to look at the experience of 40 years or more with IMF and now with the European Union, a government engages a country when it signs the agreement. It went to Parliament through the democratic process. So it doesn't happen that when you have a change in government, the next government reneges on commitments. It enters, of course, into discussion of the implementation of the program. But the program is there. It has been signed and has to be implemented.

Question: So there would be no room to renegotiate any aspects of the deal?

Smaghi: Again, it's not in line with the procedure, I would say. And this would be with a view to give Ireland a preferential treatment compared to others. So we try to apply equal treatment to everybody. So I think this is an issue of fairness.

Question: In Ireland we hear a lot from economists like Citibank's, William Buiter from The Economist Magazine, that the way things are structure now, Ireland or Greece could possibly have to restructure their debt in the future. How does the ECB assess this risk?

Smaghi: Well first you should know that when banks give advice, they may have an interest themselves. And unfortunately in modern financial markets, certain parts of the markets have an interest and an advantage if a country defaults. My point is that it's certainly not in the interest of the Irish people, especially the poorest ones, that Ireland defaults because the impact of a default would fall on the Irish people in a dramatic way. If you look at the history, again the experience that we have is only very poor countries which have defaulted and generally not democracies.

Question: How does the ECB defend protecting so-called senior bondholders in the deal for Ireland, because people – some people in Ireland say that the deal protects those bondholders at the expense of taxpayers, that they have to cover the mistakes made by international and European bankers who have invested in Ireland.

Smaghi: Well there are two ways to answer. First is that, to some extent, the Irish taxpayers, their citizens chose a model of governance and a model of taxation which attracted banks and attracted corporations. These banks paid during many years a large amount of taxation, which went to pay for expenditures and services that Irish citizens benefited from. So now there is a crisis, it is a bit inevitable that the taxpayer has to address this crisis by supporting the system, unless it wants to change dramatically, which is not the case, I understand. The Irish system does not want to change the system of taxation and so forth. So in a time of crisis, the stabiliser is the Irish taxpayer. That's the way it was chosen by Ireland.

Second, I would say that the amount of senior bonds is so small compared to the overall amount that if you give a haircut to the bonds, you merely would have a run on the banks, by the Irish themselves, by the way, because they would not trust any more that their liabilities, their assets held in the banks are safe. So you would have immediately a run on the bank. You would have a collapse of the banking system and so the banks would not lend any more to corporations. They would have to restructure their own liabilities vis-à-vis the Irish citizens. So the Irish people would in the end pay for it, in the same way as the Americans in the end paid for the collapse of Lehman.

Question: But is it not more about protecting the European financial system? It's not just about protecting Irish deposits and Irish banks, but European banks are also part of this problem.

Smaghi: You have to remind that the exposure of the Europeans to Ireland is a small proportion of the overall assets, while the exposure of the Irish people to the Irish banking system is basically 100% of all those total. So the Irish would pay much more than the rest of Europe, well the other Europeans.

Question: Has the involvement of the IMF in the bailouts for Greece and Ireland, in some ways has it undermined the credibility of the ECB in dealing with this crisis because you've had to involve the IMF?

Smaghi: Well that was a decision one year ago with Greece. I think Europe could have decided to go by itself. This was a preference, to try to manage the crisis through European institutions. Then the heads of state decided that they wanted IMF with their expertise. And since then we worked with the IMF pretty well, first in Greece, then in Ireland. I think we had a very good cooperation. So we make it work.

Question: But is this, not just the IMF, but the way the decisions are made almost along the way, has that caused difficulties in dealing with this crisis that that seems to be the European approach piecemeal?

Smaghi: Well to some extent the piecemeal approach creates a problem, but this is in the hands of the countries themselves. To some extent the Irish drama, if I can say,

was due to the fact that the Irish government decided to delay the announcement of the new package and the result to the IMF. Had this been anticipated to September, for instance, right after the downgrade, or to October, probably a lot of the drama would have been avoided and the adjustment would maybe have been less sharp.

Question: Do you really think that it could have been avoided if they'd announced something in September?

Smaghi: Well that's what the Irish government did in 2009 after the first tensions. There was a very strong reaction, very sharp measures and the markets very quickly regained confidence. Now I'm not saying that they could have done this twice, but certainly the delaying created uncertainty in the markets and accelerated then the crisis.

Question: There was some discussion that the ECB forced the Irish government into accepting a bailout package. Is there any—?

Smaghi: Well I think the markets forced the government as they were losing confidence. There was a gradual disinvestment from Ireland that we were replacing gradually, but of course this could not go on forever. So I think there was a problem of confidence in the Irish sovereign and that's what led ultimately to have to ask for assistance. There is nothing wrong, by the way, with asking for assistance. The IMF is there for that and the EU is there for that.

Question: Was there a loss of confidence from the ECB in the ability of the Irish government to handle the crisis?

Smaghi: Well I think the loss of confidence was from the markets. I think we encouraged the Irish government to take measures since the downgrading in August. For reasons internal to Ireland, I think this was delayed. There was expectation that waiting for the December deadline, which is a normal deadline for presenting the budget, would be sufficient. But the markets just didn't wait.

Question: Do you think right across Europe now that part of the solution to this crisis, it's inevitable that budgetary policies will become more aligned, will become more in keeping with the original Maastricht criteria?

Smaghi: Yes. I think we have. I think that's one of the parts of the reforms. More stricter alliance with the rules, more discipline, maybe more automatic sanctions. I hope government have understood it's better to act earlier rather than waiting the pressure of the markets. And if you need a constraint, it's better to have a constraint in terms of rule, even a European rule, than waiting for the constraint of the market.

Question: But does this inevitably lead to a loss of sovereignty on behalf of the euro member states?

Smaghi: Well loss of sovereignty, we gained to some extent, by joining the euro, most countries regained sovereignty over monetary instruments so they share sovereignty, which many didn't have before. And in exchange for that you need I would call fiscal responsibility, which is not only an issue of fiscal, by the way, because Ireland was in a relatively good fiscal position. So the reason is also to avoid the excess growth of the financial system if you want to avoid the debt of taxpayer, who ultimately bears the burden, because each country has to be ready to fill the gap when a crisis happens. So you need also control of the nominal variables, wages, credit rules, the financial sector, to avoid these growing too much and then the taxpayer is not able to stand by it.

Question: Does fiscal responsibility mean harmonising tax rates across Europe as well, do you think? Is that necessary.

Smaghi: No, I don't think so. I think it's good to have some competition in Europe because this puts pressure to reduce expenditure. So I don't think we need to have a single budget, but we need to have clear rules and to avoid the incentive to grow the budget too large. But that's a European choice, at least. I don't think we need to be American. We can be different. We can have a fiscal system which is centralised but with clear rules.

Question: So quite a lot of people in Europe seem to be dissatisfied with the Irish corporation tax rate, which is quite low. Is that – would that be the type of harmonisation of fiscal responsibilities you would see?

Smaghi: Well you see what looks strange would be looking to Ireland that Ireland wants to stick to its own tax system but then doesn't want the taxpayer to pay for it when things go wrong and wants the other taxpayers to pay for it. So I think we have to address that. I think it's right that Ireland chooses its own tax system. But then it has to have the ability to stand by it when things go wrong. When the corporation tax collapses because of a crisis, then the Irish taxpayer has to be there to stand by it, otherwise if you want – this creates some volatility, of course, and some instability. So it's nice in good times but in bad times it's pretty harsh on the taxpayer.

So you have to choose if you want this kind of volatility, but this should not create too much problem for the rest. Or if you want more stability, maybe you have to have a more balanced distribution between personal taxes and corporate taxes, for instance. That's the choice ultimately of the Irish citizens. But you have to be aware then, in bad times the Irish taxpayer cannot complain and, yes, cannot talk about what I think I read in the Irish newspapers, loss of sovereignty and having to pay for the bad guys. That's part of the model that Ireland has chosen for itself. Maybe the Irish people want to think about that.

Question: Can I ask you if you think it's a valid criticism that perhaps the ECB should have been more aware of the imbalances across the Eurozone financial

system as a whole that when large amounts of money was going into Ireland that the ECB should have said, beyond strict regulation of banks in Ireland, should have gone something wrong with the system here? It's out of balance. Maybe there's a problem.

Smaghi: Yes. Well we certainly said so in closed doors to the ministers, to the heads of state. Every meeting we raised the issue of the loss of competitiveness, excessive growth of wages, excessive growth of the financial – some certain financial development. We never raised it in public, because it was not our task, in fact. Countries are still very jealous of some of their prerogatives. Supervision is still national. Also I can mention, you remember the Irish case in 2000 when the Commission told Ireland maybe that given the growth rate, some of the measures were too expansionary and could create imbalances, I think the Irish people reacted in a very proud way and said we are doing well, why are you telling us these things?

So I think there's a learning by doing also in our countries. And we are 12 years old so we're learning from the mistakes. Maybe we should be more outspoken. We will be, I think. And the new governance system, which also looks at not only the fiscal but also the macroeconomic imbalances, we will express our views also in the future.

I think the learning has to come also from the member states, from the countries and the citizens about the risks. And the fact of being in the euro, in a monetary union, does not entail only advantages and this free flow of capital but there is a responsibility to be in line with the overall developments.

Question: Would you envisage then that the ECB in future would move beyond strictly being concerned with price stability and should take a more active role in managing the monetary system?

Smaghi: Well we have this grouping system [with the board], which, by the way, met for the first time on the 20th, yesterday. And the board will have initial responsibilities to give a commendation to the member states, to align some of their developments with the rest of the union if there are imbalances growing. So the financial stability is becoming, I think, a European call also and ECB is contributing to that. It will not be a direct responsibility. Price stability remains our main concern. But we have this new framework which I think will make a contribution.

Question: How concerned are you that this financial crisis that the euro is going through might not be over yet because people talk about problems in Portugal and Spain? Is the ECB prepared for this?

Smaghi: Well we are monitoring the developments. We know that the markets are going through phases of losses of confidence, regain of confidence, a lot of volatility. I think ultimately it is a fiscal issue. So ultimately it's in the hands of the governments, first to implement the right policies year after year. And I think if they do that the

markets will come back sooner or later to regain confidence. And second, they have to build a kind of safety net, to try to make it more systematic that if a country has problems and is willing to adjust then it's not left alone by himself in the face of the market but he's supported by the others. And I think the experience we are gaining with Greece and Ireland are going to help us to build this safety net. But again, it's the governments who have to act. It's not really a task of the Central Bank.

Question: And how much longer do you think it's reasonable for the ECB to support the Irish banking system in the way that it has done over the past year?

Smaghi: Well we are still doing it. I think also with the Central Bank of Ireland we will continue to do that. We are the central bank of Ireland though, not only of Germany or Spain, Italy, France, but also Greece and Ireland. And we have done it and we will continue to do that. Of course, conditional on Ireland now implementing the program, conducting this for the whole of the banking system, that's very important to have a more solid banking system. So all this will go on and I think we will continue to support Ireland on this basis.

Question: And you're not concerned that shrinking in the Irish banking system will lead to a loss of competition?

Smaghi: Well I think it may lead to certainly a sounder system and a system that the Irish taxpayer will prefer ultimately. Having a big financial system, too big a financial system, ultimately it may be a dangerous element for the taxpayer.

Question: Okay. Mr Bini Smaghi, thank you very much. Okay. Excellent. Thank you very much.

Smaghi: Thank you.

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