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## Interview

### There Are More Reasons Today for Europeans to Unite Closely

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Former President of the European Central Bank

- 1. You have just left your position as President of the European Central Bank. As the euro faces the biggest crisis since its creation, how do you feel with regard to the eight years you have just spent as head of the ECB?**

For me and for all my colleagues, these past eight years have been of capital importance. We have had to consolidate the credibility of the single currency during its first few years, ensure price stability – in accordance with the promises made to the peoples of Europe – and ensure that the real economic aspect of the Economic and Monetary Union (E.M.U) – namely the Economic Union in itself – was fully respected, which, unfortunately, has not been the case. In addition to this, over the past four and a half years we have had to deal with the most serious international crisis since the Second World War.

Within this exceptionally difficult and turbulent context, my colleagues on the Board of Governors and I have endeavoured to provide an anchor of stability and confidence to all our fellow European citizens.

- 2. In your opinion, what are the main lessons to be learned from the recurrent crises that have hit the euro zone since 2008? What do you have to say in terms of the action taken by the European Central Bank, and by other community and national players, in their attempts to respond to them?**

For the European Central Bank the turbulent phase of the world crisis started in 2007. On 9<sup>th</sup> August 2007, the European Central Bank was the first central bank in the world to take the first “non standard” measure of the crisis, by providing limitless fixed rate liquidity to the commercial banks that asked for it, representing a total amount of 95 billion euros. It should be understood that what we have been experiencing for the past four and a half years is a worldwide crisis and not merely a European crisis. May I suggest the following three-phase analysis of how the world crisis developed?

Phase one: from August 2007 to mid-September 2008, that is to say from the beginning of turbulence on the money markets of developed countries through to the time when Lehman Brothers went bankrupt. This period was marked by a very high level of turbulence on the monetary and financial markets. The crisis was worldwide and its epicentre was in the United States.

Phase two: from mid-September 2008 to the end of 2009. A dramatic intensification of the financial crisis was observed in all developed countries. Almost all private financial institutions were directly or indirectly threatened with a major risk of knock-on bankruptcy and generalised economic depression. Throughout this phase, the epicentre of the world crisis continued to be in the United States.

Third phase: this began at the beginning of 2010 and continues today. After the financial institutions' position stabilised and the gradual recovery of economies was confirmed in the wake of the most acute recession since the Second World War, which did not turn into the threatened "great depression", the world crisis began to strike at "sovereign" risks, and indeed the signature of developed countries. The world crisis continues, but its epicentre has crossed the Atlantic and is now in Europe, and more specifically in the euro zone.

It must be understood that all developed countries, almost without exception, now need a major review of their economic strategy and the management of their public finances. This is true in the United States, in Japan and in Europe. No major economic zone amongst developed countries can do without this strategy review. From this point of view, the case of the euro zone is paradoxical in many respects. Taken overall its position is one of the best amongst industrialised countries, whether in terms of annual public deficits – about twice as small, in proportion to GDP, as those of the United States or Japan in 2011 – outstanding public debt in proportion to GDP or the equilibrium of the balance of payments. But in spite of this situation, which is overall very favourable, some economies in the euro zone are amongst the most vulnerable of all industrialised countries. The deficient functioning of the Economic Union and the lack of control or effective monitoring of Member States' economic and budgetary policies have played a major role in these vulnerabilities.

The situation can be summed up in four points:

- Firstly, all advanced economies are now facing the most serious economic and financial crisis since the Second World War
- Secondly, the world crisis is one of adaptation by developed countries to the new globalised world that has been gradually created over the past thirty years.
- Thirdly, within the euro zone, that is to say the Economic and Monetary Union, the "Monetary Union" itself has complied with what was expected of it: to ensure monetary credibility and stability.
- Fourthly, within the Economic and Monetary Union, the "Economic Union" requires very substantial improvement. The rules initially set, particularly in the Stability and Growth Pact, have not been followed. In any case they were vastly insufficient. Considerable reinforcement of euro zone governance is now essential.

**3. The crisis would appear to have strengthened the ECB's role; its role as lender of last resort alone would appear to reassure the markets. What role would you like to see it play in the future? To what extent would you be favourable to an increase of its powers and, particularly, beyond the targeting of inflation using interest rates, an extension of its mandate to the monitoring of credit expansion and bubbles?**

The ECB has been true to its primacy mandate which is to ensure price stability and issue a credible, stable currency. This is a necessary condition – but one that is not sufficient in itself – to sustainable growth and sustainable job creation. I say that it is not a sufficient condition on its own because a good budgetary policy is also necessary, along with close

monitoring of competitive indicators and unit production costs and a policy of structural reform – all policies that do not depend on the central bank – in order to ensure optimal growth and to eliminate mass unemployment. However, price stability, as I said, is a necessary condition for lasting prosperity.

Over the course of the euro's first thirteen years, in spite of several oil crises and increases in the cost of raw materials, average annual inflation was 2%, in line with the definition of price stability given by the Board of Governors. All of the opinion polls carried out across the euro zone have always showed that our fellow citizens are extremely attentive to price stability, particularly the poorest and most under-privileged amongst them. Whilst remaining rigorously loyal to the first mandate given by our democracies and constantly confirmed by the popular feeling reflected in the polls, the ECB Board of Governors was always careful to take exceptional decisions required without delay, in order to face up to the new situations newly created by the crisis: as I have already said, our first “non standard” decision was taken as early as on 9<sup>th</sup> August 2007.

To ensure that it was clear that the quick, proportionate response to the crisis was never made to the detriment of the ECB's first objective, we instituted, right from the very beginning of the crisis, a principle of separation between “standard” decisions of monetary policy (mainly the interest rates level) and “non standard” decisions (mainly the granting of liquidities at fixed rate without limit, interventions on the secured bonds market or on the bonds market in general). “Standard” decisions are taken to ensure price stability in the medium term and therefore the credibility of the currency with a view to the medium and longer term. “Non standard” measures are taken so that transmission to the economy of “standard” measures happens in the most satisfactory conditions possible, taking account of the very serious dysfunctions seen in several markets – or market segments – caused by the crisis.

I believe that the ECB has always proved that it is daring, imaginative and reactive, whilst remaining true to its mandate. I believe that it would be counterproductive to change its mandate. The Central Bank can do a great deal. It has proved as much. If it had not been highly present, strong, lucid and quick, over the past four and a half years, including the last months, since July 2011, we would have witnessed still more serious events. But the Central Bank cannot substitute for the States themselves. It cannot substitute for either governments or parliaments.

#### **4. The current climate is marked by a very high degree of uncertainty and disarray under the effect of a never-ending economic and political crisis. How can this “crisis of doubt” which is affecting both the euro zone and the European Union be overcome?**

This is not the first serious crisis that European integration has had to face. Our history since the Second World War shows that periods of crisis have always been used by the Europeans to make further progress. I am sure that this will be the case again here.

The world crisis has acted like a revelation, showing up structural weaknesses in the various economies of developed countries. Europe has its weakness: economic governance that is highly insufficient. But all developed countries have their own weaknesses: it would be an illusion to believe that the world crisis is mainly a European one. This was clearly not the case during the first two phases of this crisis, when its epicentre was in the United States. It is not the case now either, even though the epicentre is now in Europe.

Europeans must be advised to use lucidity: the world crisis is not merely European. They should keep a cool head – we have our own strengths and weaknesses. But we also need courage and determination. Our weaknesses must absolutely be corrected and the crisis is a unique opportunity to do so. We now know what our weak points are. The ECB itself did not wait for the crisis before denouncing the abnormalities of our economic governance.

**5. Reading the various speeches you made as President of the ECB shows that the current crisis highlights a certain number of challenges set for “governance” of the euro zone. What are these challenges and what are (or would be) the resources needed to face them?**

In terms of budgetary policies, right from my arrival at the European Central Bank at the end of 2003-beginning of 2004, the Board of Governors had to combat a coalition of big States who had decided to weaken, not to say withdraw, all authority from the Stability and Growth Pact. France, Germany and Italy in particular were closely associated in this perverse and retrospectively absurd undertaking. On behalf of the Board of Governors I indicated our resolute opposition to this manoeuvre and I expressed publicly our serious concerns with regard to how the euro zone could operate under these conditions.

In terms of economic policies, over and above mere budgetary policies, the Board of Governors was convinced, right from 2005, that careful and rigorous monitoring of nominal developments in costs and prices in the various member economies was necessary, along with monitoring of their internal and external imbalances. The significant divergences in developments in unit production costs in particular, called for real multi-lateral supervision and, where necessary, precise recommendations in terms of economic policy. The idea that divergences in the development of costs and competitiveness would be gradually spontaneously corrected by the working of the market (by the “competition channel”) did not appear to be right. These “spontaneous” corrections proved to be unworkable, particularly in economies where the export sector represented only a relatively small fraction of the economy as a whole and therefore had very limited influence on the formation of costs and prices. During the last seven years the monthly display by the European Central Bank of figures on national evolutions in costs and prices showed abnormally divergent nominal developments since the creation of the euro, in spite of the fact that the currency was the same. This was particularly visible in the field of salaries in the public services which, in some countries, systematically developed year after year more quickly than the average in the euro zone, whereas the country was suffering from a major deficit both internally (public finances) and externally (balance of current payments).

It was these observations that led the Central Bank to recommend the creation of a new additional framework for monitoring indicators of competitiveness and internal and external imbalances, in addition to the Stability and Growth Pact. We also constantly recommended very substantial reinforcement of the decision-making mechanisms within the Commission and the Council, such that the necessary corrections could be made as early and as automatically as possible: experience has clearly shown the exorbitant cost, both for the countries concerned and for the whole of the zone, of negligence, hesitation and delay.

**6. The crisis would appear to be leading to a federalisation of the European economic policy. Nevertheless, can continued integration be content to move forward only under the demands of necessity, without any democratic debate, particularly with regard to budgetary federalism? If necessary, how could this kind of debate be started? Also, you have underlined several times – and notably at Humboldt University in Berlin – that for half a century European integration found its meaning in introversion and that it is now time to give it an external extension for the future. How could such a conversion be actually encouraged?**

I have always demanded strict compliance with the Treaty in this regard, as well as strengthening of the economic Union, which is the essential counterpart of the monetary Union, as the acronym E.M.U. suggests.

That means that we must, in my opinion, go as far as possible in reinforcing the supervision of each economy by the Commission and by the Council. We must also go as far as possible in the establishment of the recommendations deemed indispensable, and in their effective implementation.

On this basis, I have suggested, in various speeches delivered in June and October 2011, three possible stages, which I can resume as follows:

First stage: use all the possibilities offered by the current treaty to supplement and reinforce the secondary legislation of economic governance. This first stage has already been accomplished. My wish, in the name of the ECB, was for the new texts that have been decided within the context of the “six pack”, to be able to go further still. But even as they are they represent a significant improvement compared to the previous position. And I must say that the Commission on the one hand and, in particular, the European Parliament on the other, have played a very useful role in pushing the governments in the right direction, particularly that of reversing the burden of proof in terms of recommendations and sanctions. With regard to the democratic functioning of Europe, I would insist on the European Parliament which plays an essential role in our democratic institutions and looks to me really driven by the spirit of Europe.

Second stage: go further than that which is currently authorised by the treaty. I have pointed out that, in a monetary zone whose overall stability could be challenged by repeated misbehaviour by one of its members, the central authority has to impose decisions that are immediately enforceable on a member country. Of course this presupposes that this country repeatedly refuses to apply essential recommendations. Is it not legitimate, when we share the same currency, for the Council of governments, on proposal by the Commission, to be able to impose the wise decisions that avoid a risk of catastrophe in the whole of the euro zone? That, in my opinion, is the very heart of the concept of “governance” of the euro zone. What is real economic governance in the EMU? It is not an entity that is permanently and indiscriminately interfering and substituting for national authorities. But it isn’t a “paper tiger” either, taking decisions that are never enforced.

Events over recent years in Greece as well as in other countries, demonstrate the relevance of this second stage. This naturally means a profound legal change and, therefore, either an amendment to the treaty or a new one. I suggested a change such as this in a speech given in Aix-la-Chapelle<sup>1</sup>. Things have progressed a great deal in the direction of this “second stage” and a new treaty is currently being negotiated. I sincerely hope that the results of these negotiations will be commensurate with the challenge facing Europe.

Third stage: within a much longer perspective, it is legitimate for a European citizen to think about how our institutions will develop. One thing is certain: we have not yet reached the definitive state of our institutional structure. In a speech given at Humboldt University<sup>2</sup>, I imagined how European institutions could evolve very substantially in the future, with the Council becoming the upper chamber, the Union’s Senate, the European Parliament having all the powers of the lower chamber and the Commission becoming an executive power, fully responsible to Parliament. With regard more particularly to the Economic and Monetary Union of the future, within this renewed institutional context, the Union’s Finance Minister would have, amongst others, three main responsibilities: responsibility for the supervision of Members States’ economic and budgetary policies and, where applicable, of the second stage “enforceable decisions” referred to above, responsibility, in terms of executive powers, for supervision and regulation of the financial sector and representation of the Union in international financial institutions.

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1. Speech given at the Charlemagne Prize-giving ceremony, 2<sup>nd</sup> June 2011.

2. Speech given at Humboldt University on 24th October 2011.

**7. At the Charlemagne prize-giving ceremony in 2011 you declared “It is essential that all nations demonstrate their total commitment in favour of the historic destiny followed by Europe, and look to the future with confidence”. In your opinion what are the reasons for being confident about our future in the medium and long term?**

All the previous thoughts are the personal remarks of a European citizen. Europe’s future is in the hands of the European democracies, in the hands of our fellow citizens, who are our masters, the decision-makers. I am confident, in spite of all the difficulties that we have to face, for three main reasons.

Firstly because there are still more reasons today for Europeans to unite closely than there were just after the Second World War. 65 years ago we had only one model of a vast and continental “single market”, the United States of America. In four years time the gross domestic product of China will exceed that of the euro area at purchasing power parity and the combined GDP of China and India will represent twice that of the euro area, again at purchasing power parity. We have to face an entirely new world, one that has been totally reconfigured over the past thirty years, with the generalisation of the market economy and globalisation.

Secondly, because the crisis experienced by all developed countries offers a unique opportunity to identify and correct our own European weaknesses. In the prospect of permanent adaptation to the new world economy, all developed countries must correct their imperfections. Ours have been identified, are visible and demand tremendous improvement to our governance. Those improvements are within our reach.

Finally, because the historic challenges are considerable, not only for European stability and prosperity, but also for stability and long term growth for all world nations. They are watching us, not only as a decisive partner in view of our economic, commercial and financial size, but also as the first continent to experiment a new kind of governance, which necessarily combines important elements of national sovereignty and today’s necessary elements of sovereignty shared at multinational level.