

There is No Quick Fix

An Interview with Jean-Claude Trichet

Jean-Claude Trichet is the Governor of the Bank of France and is currently scheduled to be the second President of the new European Central Bank. World Economic Affairs wanted to know about Trichet's views on the Asian crisis and on the prospects for the euro in the coming years. He was interviewed in Paris by Marc Uzan, consulting editor for World Economic Affairs and Executive Director of the Reinventing Bretton Woods Committee in New York.



W EA: WHAT IS YOUR READING OF the Asian crisis?

Trichet: Regarding the Asian crisis, I think that one needs to use caution on the diagnosis because the situation is still evolving, and there is no consensus from the experts. I believe that we need to beware of two mistakes. The first mistake is to overrate the crisis. It seems to me that the emerging Asian economies are experiencing a growth crisis. They have had extraordinarily fast economic growth in the past few years under conditions that experience has proven are not sustainable in the long run. Yet, I think that it would be an error to say that we are faced with an absolutely severe structural crisis. We need to use the metaphor of a "growth crisis", which does not mask its seriousness, but doesn't ques-

tion these economies' long-term prospects. To me, these prospects are still a flattering catching up of the living standards reached by industrialised countries.

The second, and equally dangerous, mistake would be to underestimate the crisis and misjudge it as identical to past crises, especially to the debt crises we encountered in the 1980s. It so happens that I was very active in the 1980s' debt restructurings as President of the Paris Club, which contributed to finding solutions, by way of a consensus between debtor and creditor countries, to crises that were very serious but of a different nature. I believe that we should

avoid revolutionary changes to the architecture of the international monetary system. We need strong improvements of a pragmatic nature. The

international community is experiencing transformations of great magnitude: the globalisation process and the interconnection of capital markets, which are both irreversible. It would be a huge mistake to go back in time. It is true that the world as we see it today is very

different from the one we knew ten years ago.

We are living in a time of massive technological change and we have a tendency to underestimate its importance. For example, consider the

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decrease of the cost of information—we have to take into account that this shock had not yet occurred in the early 1980s. It is also important to recognise that commercial banks, which used to play an essential part in international financial intermediation, now find themselves playing a far more modest role. Markets now play a more important role, especially in financing development in the emerging economies. And we are now feeling the effects of inventions that derive from this process of marketisation.

We should not misjudge the present state of the world; nor should we construct an international framework that would be obsolete as soon as it is built. We can't leave the world economy to chance; we need regulations. Yet, we also need to let changes take place, without restricting these changes in an incoherent way. That is the difficult task of our time—to draw the line between concept and spontaneous evolution of opportunities and risks, between successes and crises.

WEA: After the Mexican crisis, G-7 countries discussed the establishment of crisis-management mechanisms. Now, two years later we have the Asian crisis. What do you think should be done to build a new architecture for the international financial system?

Trichet: I think there are two very different issues here—the prevention and the healing. And you have to distinguish them. Prevention must be intensified, while keeping in mind that a market economy without risks or crises is unthinkable. Not everything can be regulated. Within the international financial community, a real consensus currently exists and can be seen in work by the IMF, the World Bank, or the Willard Group. Whatever the group, there is a strong agreement on the notion of transparency—in order to function efficiently, high quality information is needed. I think a code of conduct will gradually be established at the macroeconomic level that is likely to include rules on external debt in foreign currencies and on the level of the

balance of payments deficit. This code of conduct will help to clarify each country's policies, including those on foreign direct investment (FDI), and make them easier to assess by international investors.

Similarly, there is a consensus on the view that FDI is a fundamental element in the orderly functioning of an interconnected world because, in a way, FDI

finds its own repayment in the nature of the investment. It is therefore anchored in the real economy, and the pairing of the financial sphere and real sphere becomes automatic and immediate. It contrib-

utes to the necessary unification of our interconnected world. If you create connections between different economies without linking them to the real economy, and thus have only the financial relationships, then you create a less stable world.

Another very important part of the emerging consensus is that the systemic nature of banking and insurance systems becomes more and more obvious to the world economy. In this context, the work of the Group of 10 is extremely important. Basle Core Principles are vital. There you have an obvious consensus on the prevention issues. As regards resolving the crisis, there is clearly no quick fix.

As former President of the Paris Club, I believe that, even if crises are not similar, we can benefit from past experience. There are some principles that we obviously cannot ignore. The first one is that when a crisis erupts, we either manage to settle it in an amicable way, or we don't. Settling a crisis in a co-operative way means not interrupting the country's payments, not declaring that payments are no longer possible, and not seeing one's signature held away from international capital markets and from international financial institutions. In many cases, it is possible to settle the

matter in an amicable way. Therefore, we give it a try. We are able to do so when a country has to deal with a liquidity problem that can be settled by debt payment restructurings. We have a number of examples from the 1980s where countries managed to avoid the non-amicable settlement. In such cases, the situation appears much better. Korea managed to proceed through the amicable settlement. In one case, we talk of debt restructurings; in another one, of reschedulings. The first case is about maintaining payments, the second one is about interrupting them.

The second principle has to do with rescheduling. With debt rescheduling, we find ourselves in a situation where we have to obey a principle that also applied in the 1980s—each partner must make a proportionate effort. There is, in a way, an optimum of efforts that is required from all parties if you want to find a solution to the crisis. It means that the affected country proceeds by itself to an important adjustment—it puts the economy back on its feet. This is the country's contribution. Naturally, it is absolutely necessary to get the green light from the IMF and the international community showing that the efforts are appropriate.

Difficulties arise when you deal with external debt held by individual bondholders. The principle is the same as it

was in the 1980s. The application point is different since we have now a new problem related to the incredible extent of securitisation and, consequently, to the fact that creditors are bond- and stockholders. In the current system of crisis management, the so called New York or London Clubs are in charge of co-ordinating the commercial banks and the

Paris Club is in charge of co-ordinating the governments. But how should we deal with individual bondholders? When all securities are denominated in local currency and within the local market, the contribution from external capital holders is delivered through deprecia-

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tion of local currency and depreciation of local securities markets. International investors therefore face losses through the decline of the securities' value. The essential problem arises with securities denominated in foreign currency. This is where you find moral hazard—when you have a dollar-denominated debt with an important risk premium, and holders benefit from the risk premium but face no risk because they believe it is impossible to restructure the debt. That is when you have moral hazard. Commercial banks must make a significant contribution, not necessarily through capital losses, but possibly through debt reschedulings.

The IMF is not a substitute for regular private capital flows. The IMF needs to strengthen its capabilities for intervention in the world economy and for market development, but I do not believe that the IMF should always intervene. If we do have an optimum as far as the different actors' contributions are concerned, then the role of the IMF is simply to tell what is right in terms of recovery policies. Yet, financing the balance of payments deficit should essentially stay in the hands of the different creditors involved. Otherwise, you create moral hazard.

WEA: Should the IMF warning and surveillance process be made public?

Trichet: We have to be prudent. The IMF must be extremely cautious in its warnings. Since public warnings may precipitate a crisis, the IMF must make warnings public only if it thinks that nothing else can be done, and if no economic policy strategy adjustment from the involved country is expected. If the IMF believes that the crisis can still be avoided and that an adjustment in policy can be obtained voluntarily from the government concerned, then an immediate public warning is not necessarily the most appropriate tool, and bears the risk of triggering a possibly avoidable crisis. But I strongly recommend warnings in cases where the IMF assessment

is that no policy action is to be expected from the country involved.

WEA: Do you think the European experience in monetary co-operation can serve as an example for Asian countries?

Trichet: You have to beware of analogies. The European Monetary Union is linked to European history. There is a very strong weight of history. It is difficult

a mistake this was. Now, on the contrary, people talk of a super dominant euro. Excess of honour today, excess of indignity yesterday.

I believe that the euro, at least during its first years, will follow the same behaviour as its underlying core currencies. What gives the euro its credibility are these European currencies—the French Franc, the Deutsche

Mark, the Guilder and some other currencies which constitute the foundation of the euro's future credibility. Therefore, the first reading on the relationship between the euro and the dollar will be found in the continuity of these European currencies. After a number of years, economic agents will give their judgement according to the signals

given by Europe. I believe that the world economy is growing so fast and that the need for financial products is growing so constantly that there is room for both the dollar and the euro in the world that is taking shape in

front of us. It is also important for both of these currencies that Europe and the United States share the same economic values. We do not have any strategic disagreements. This is very remarkable. We are in favour of budgets close to equilibrium or in surplus. As for monetary policy objectives, we are also in agreement. Europe must ensure currency stability for non-inflationary growth in the long run. And it is the same in the United States.

My experience tells me

that you only find serious monetary troubles when conceptual disagreements exist. Therefore I am confident.

WEA: Thank you very much for this interview. ♦



to find exactly the same relationships in emerging economies. But, the truth is that there are many common elements in these countries' environments at the financial and strategic levels. As suggested by contagion effects, international investors, often mistakenly, tend to group the Asian countries together as all being the same. I believe the strengthening of co-operation between the Asian countries will not necessarily follow a European-style model. Lessons to be learned from recent events do concern increased local co-operation; but more importantly the lessons concern the need for strengthening measures to prevent such crises from happening in the first place.

WEA: What are the international implications of the euro?

Trichet: There are many different schools of thought. Six months ago, the trend was to predict a weak euro. At that time I explained how fundamental

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