Jean-Claude Trichet: Lessons to be learned from the European sovereign debt crisis – interview with *Libération*

Interview with Mr Jean-Claude Trichet, President of the European Central Bank, in *Libération*, conducted by Mr Jean Quatremer on 8 July 2010 and published in French via his blog on 13 July 2010.

* * *

Q: Is the sovereign debt crisis that has rocked the euro area since last January over now?

A: The concerns of investors and savers over sovereign debt are a global phenomenon and have particularly affected industrialised countries. Indeed, industrialised countries were hit hard by the financial crisis of 2008 and 2009 and, for the most part, their government financial accounts suffered badly. In the particular case of Greece, some investors were convinced that the Greek government would be unable to take the bold decisions that were absolutely necessary, and that neither in Europe nor within the international community would there be the capacity to support its recovery plan. On a more general level, the ability of the Europeans to face up to a difficult situation seems to me to have been seriously underestimated initially. Consider that, at the time of speaking, we have a recovery plan for Greece that has been approved by the International Monetary Fund, by the European Commission, in liaison with the European Central Bank (ECB), and by the European governments of the Eurogroup. Several European countries have adopted ambitious recovery packages. All of them have committed to stepping up their fiscal consolidation. The euro area governments decided to support the Greek recovery plan to the tune of €80 billion. They also decided to set up a financial stabilisation fund (European Financial Stability Facility) for the euro area with guarantees amounting to €440 billion, and this on top of the above-mentioned €80 billion and the €60 billion which can also be mobilised at the European Union level. Just a few months or even weeks ago, investors deemed all of this impossible. They are progressively taking these decisions into account.

Q: Was it the case, then, that the markets underestimated the political will of the European Union?

A: There is a tendency among some investors and market participants to underestimate Europe's ability to take bold decisions. In their defence, I would simply say that the institutional structure of Europe is very different to what they are used to, especially on the other side of the Atlantic. The decision-making processes are not the same. But it would be a mistake to underestimate Europe, in general, and the euro area, in particular.

Q: The markets attacked Europe precisely where it is most vulnerable, in that it has a federal monetary policy without a single economic and fiscal policy.

A: This is not how I would describe matters. Since the severe crisis that erupted in 2007, which we countered by avoiding a recession that could have been as devastating as the one in 1929, all fiscal policies of the industrialised countries have been vulnerable, and not only those in the euro area. The scale of the recession has significantly weakened a number of budgets that were already in difficulty. I do not see what happened – and what is in the process of being gradually resolved – as a targeted attack on the sovereign risks of the euro area, but rather as questioning the fiscal policy of industrialised countries. Some countries have shown themselves to be more vulnerable than others. Certainly, it immediately calls into question the quality of the surveillance of fiscal policies undertaken by the other governments.

Q: Wasn't it the case that Europe responded too late to the sovereign debt crisis, given that all the elements of the crisis were in place as early as January 2009?

A: It was first necessary for the countries that were afflicted by a lack of market confidence to adopt a fiscal policy that would enable them to convince all market participants. That is what Greece failed to do in 2009. This made all the difference for a country like Ireland, which – despite the severity of its situation – drew up in advance and adopted a large-scale recovery programme without waiting to find itself in extremely difficult circumstances vis-à-vis investors. What is more, in the case of Greece, there was the unusual and very grave problem of false data. That is why the Governing Council of the ECB and, in particular, Christian Noyer, Governor of the Banque de France, is stressing the need for an independent body, preferably within the European Commission, that is able to lay down the law as far as statistics are concerned and establish a reliable fiscal assessment. This is a key point: if the real figures had been known, it is likely that things would have turned out differently.

Q: Why did you wait until 10 May 2010 to intervene in the secondary market for sovereign debt by purchasing Greek bonds and those of other countries? If you had done so earlier, you would have tripped up the speculators.

A: We acted because we saw a serious and unprecedented malfunctioning of the financial markets of certain euro area countries in the afternoon of 6 May and on Friday 7 May. At that moment in time and not before, we judged that we had a very serious problem with regard to the transmission of our monetary policy in part of the euro area, and that we had to contribute to re-establish a more normal functioning of the markets in question. Our aim was not to change our monetary policy, which is to maintain price stability for our 330 million fellow European citizens. Inflation is a tax on the poor and most vulnerable.

Q: So the ECB isn't there to mop up the reckless spending of Member States?

A: The central bank is certainly not there to rectify the fiscal mistakes of governments, mistakes it constantly warned them about.

Q: Nevertheless, you have already purchased government bonds to the value of €59 billion. That is a huge figure!

A: Those interventions are sterilised. We are maintaining our monetary policy unchanged. We believe that the present monetary policy is appropriate in order to maintain price stability. In order to avoid changing our monetary policy by increasing liquidity, we are completely re-absorbing the liquidity provided as a result of these interventions.

Q: Isn't the ECB becoming a sort of "bad bank" which allows commercial banks to get rid of their dubious sovereign bonds?

A: No, the sole aim of our interventions is to help us to improve the transmission of our monetary policy by contributing to the better functioning of certain bond markets.

Q: Isn't there a risk that the next stage of the crisis will occur in the private debt security market, as seen in Spain, where credit institutions are very vulnerable?

A: The calling into question of certain private debt instruments was the source of the international crisis that we are experiencing. It is as a result of this "private" crisis that we have been faced later with the problem of sovereign debt risk. All industrialised countries must strengthen the soundness and credibility of all public policies, and in particular fiscal policy. It is also essential that the overall balance sheets of certain institutions continue to be adjusted. This is now happening through the "stress tests" which Europeans have fortunately decided to conduct, the results of which will be published, bank by bank.

Q: Are there many skeletons still hiding in the closets of banks?

A: The purpose of the stress test is to measure the resilience of banks in especially difficult circumstances. Transparency is very important. This is what we have also seen in the United States, where in the past there was a general absence of confidence, which was rectified by the publication of such stress tests.

Q: Is greater fiscal integration necessary to avoid a repeat crisis of this nature?

A: We must, in particular, be able to go as far as possible, without necessarily changing immediately the Treaty, notably with regard to very early surveillance, almost automatic sanctions, and the strengthening and extension of sanctions so that the euro area has the equivalent of what we would have if we were in a fiscal federation.

Q: But wouldn't a federal budget be the ideal solution?

A: A federal solution would require a huge leap forward at the institutional level. It seems to me that a fully fledged political federation is not, at present, wanted by the countries themselves, speaking as a citizen, it is a matter of regret to me that the chance to take further steps was not seized in the 1990s. In the meantime, responsibility for the economic union itself – as part of the economic and monetary union, the EMU – rests with the Member States themselves. They, of course, fulfil this responsibility within the framework of their own national institutions. That being said, the "peers", namely the other governments, duly guided by the European Commission in liaison with the ECB, should not hesitate to meet all their own responsibilities: they should ensure that none of them adopts policies that could undermine the stability of the euro area as a whole. They have just seen for themselves the extent to which they share a common destiny.

Q: Why not jointly manage some of the debt of European States?

A: We have always been opposed to merging treasury operations, because this would strip States of their responsibilities and they would lose the financial incentive for sound governance.

Q: Do the austerity plans announced amid monumental disarray by the Member States pose the risk of killing off the first green shoots of growth?

A: It is an error to think that fiscal austerity is a threat to growth and job creation. At present, a major problem is the lack of confidence on the part of households, firms, savers and investors who feel that fiscal policies are not sound and sustainable. In a number of economies, it is this lack of confidence that poses a threat to the consolidation of the recovery. Economies embarking on austerity policies that lend credibility to their fiscal policy strengthen confidence, growth and job creation.

Q: Should a European rating agency be created, since the Anglo-Saxon agencies have added fuel to the flames during this crisis?

A: Rating agencies in general have had a pro-cyclical impact. They tend to amplify upward and downward swings in the financial markets. This is still obvious today. This runs counter to financial stability. It is probably advisable to put an end to a global oligopoly of three agencies. But the fundamental problem is to reduce, or eliminate, this amplifying effect that the rating agencies contribute to.