Ignazio Visco: Tommaso Padoa-Schioppa, "Architect …"

Personal remarks by Mr Ignazio Visco, Deputy Director General of the Bank of Italy, at the Ceremony in memory of Tommaso Padoa-Schioppa, European University Institute, Badia Fiesolana, 28 January 2011.

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A prominent (but non-academic) economist, a leading central banker (in Italy and in Europe), a "non-political" politician (dedicated to the "polity" rather than to the *politique politicienne*), Tommaso Padoa-Schioppa spanned all of these professions in the course of his eminent career. Tommaso's achievements were substantial, as everyone recognizes. He is rightly considered as one of the "architects of the euro." A man of vision, an independent mind, an indefatigable civil servant – we have been fortunate indeed to have had Tommaso Padoa-Schioppa as colleague, friend, mentor.

Mine will not be a eulogy or a historical account of Tommaso's many achievements. Division of labour and the time constraint have counselled concentrating on his contributions as an officer of the Bank of Italy. Perhaps the term "officer" is a bit limited, although I am sure that he would have appreciated it. He was the head of the Money Market Division of the Bank's Research Department from 1975 to 1979, when he left to become Director General for Economic and Financial Affairs at the European Commission. He returned to the Bank in 1983, was named Deputy Director General in 1984 and served in that capacity for thirteen years. He certainly left his mark. Developments in at least three areas would most likely have been substantially different, and with a cost-benefit balance substantially in the red, had his influence not been exercised so effectively. The three areas comprise the "reshaping of monetary policy", as he came to define it,[1] the promotion and implementation of a ground-breaking reform of the payment system[2] and the process of European monetary unification.[3]

These recollections of mine are certainly not exhaustive, and if in places they are marred by some inevitable inaccuracies, let me apologize in advance. More than two decades of observation of Tommaso's accomplishments at the Bank, with at times lengthy discussions, followed by a decade and a half of exchanges after his departure to become successively Chairman of Consob, Member of the Board of the ECB, and Italy's Minister of Economy and Finance cannot be summarized in a few minutes. And memory is sometimes incomplete and distorted, even if I have had the benefit of some brief conversation with some of his closest collaborators during those years.[4] In any case, I am sure that my recollection of his accomplishments errs on the side of understatement.

Let us remember that in the 1970s the Italian economy was plagued by substantial nominal and real instability. High and volatile inflation rates preceded, accompanied, and followed a series of large and sometimes sudden depreciations of the currency, in a context of social unrest and substantial rigidities. For several years the economy we lived in was the "100%

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[1] I will only provide very limited references to his extensive written contributions, but on the reshaping of monetary policy we are fortunate to have his views and assessment summarized in the contribution to Franco Modigliani's Festschrift (*Macroeconomics and Finance, Essays in Honor of Franco Modigliani*, edited by Rudiger Dornbusch, Stanley Fischer and John Bossons, MIT Press, Cambridge, Mass., 1987, pp. 265–86).

[2] A collection of Padoa-Schioppa's speeches and papers on the payment system has been published, in Italian, in the book *La moneta e il sistema dei pagamenti*, Il Mulino, Bologna, 1992.

[3] It is sufficient here to refer to the writings contained in his book on *The Road to Monetary Union in Europe*, Clarendon Press, Oxford, 1994.

[4] I would especially like to thank Giovanni Carosio, Francesco Papadia and Franco Passacantando for sharing some of their memories with me in the process of writing down these recollections.

plus" indexed economy described in well-known essays written together with Franco Modigliani in 1977–78.[5] Meanwhile, Italian society was racked by violent waves of terrorism. The policy challenge was enormous, as Italy's financial markets were very underdeveloped, public debt management non-existent, and capital flights massive. The large and rising budget deficits were being financed only by the central bank and the banking system. Financial repression was extensive, with such administrative measures as controls on capital movements, interest rate caps, ceilings on bank credit to the private sector, and constraints on banks' portfolio investment.

Administrative controls became a generalized system of monetary and credit management. It required monitoring and supervision, as well as the capacity to balance the inconsistencies and conflicts that necessarily flowed from the lack of market infrastructures, the co-existence of qualitative and quantitative credit controls, and the central bank's inability to affect the interest rate. Tommaso experienced this in his daily activity, which included constant advising to the Bank's governors as well as to the government. And in that same period, the Bank of Italy was laying the foundations of a "new system" that would shift over to indirect monetary controls and open market operations. The compulsory reserve regime was radically revised, the method for issuing Treasury bills was reformed to admit the Bank's participation at auctions and enhance its ability to affect the interest rate.

In 1981, while Tommaso was serving with the European Commission, an epoch-making regime shift took place, to which he had contributed directly and indirectly: the so-called "divorce" between the Bank of Italy and the Treasury. The Bank ceased to act as residual buyer at Treasury bill auctions, the fundamental first step towards full independence for the Bank's monetary policy decisions. This was followed in the 1980s by a thorough transformation of the financial infrastructure: direct controls were suppressed, reserve requirements reformed, competitive-bid auctions for Treasury bills introduced, longer-term Treasury bonds (with the introduction of uniform price auctions) and indexed Treasury credit certificates were instituted, a screen-based secondary market was established for government securities (the MTS, with the introduction in 1994 of market specialists) as well as a screen-based market for inter-bank deposits (later to become the e-MID), futures and options on Treasury bonds were launched on LIFFE, and more. Tommaso Padoa-Schioppa contributed much of his time, energy, and vision to these radical changes.

Many other changes took place over those same years. The European Monetary System (EMS) was established, in the second half of the 1980s exchange controls were removed and capital movements were completely liberalized (by 1990), the Bank of Italy was granted not only de facto but also de jure independence, the wage indexation system was substantially revised and eventually put to rest, and a major currency and financial crisis struck the Italian economy as budget deficits and the public debt seemed to be out of control. Eventually, of course, the crisis was overcome, inflation was tamed, the public finances were brought under control. This is clearly another story, one that took a benign turn thanks also to the many infrastructural changes that had made it possible for monetary policy to play its proper role within a transparent and well-organised financial architecture.

It is natural, today, to take it for granted that a transparent and well-organised financial architecture necessarily includes a smooth, well-functioning and economical payment system for clearing and settlement. But this is a relatively recent achievement, one that has benefited greatly from the information and communication technology revolution. In the mid-1980s the payment system, and not only in Italy, was rather neglected and far from well-organised. Tommaso was convinced that central banks' tasks should comprise not only money creation

[5] Franco Modigliani and Tommaso Padoa-Schioppa, "La politica economica in una economia con salari indicizzati al 100% o più", in *Moneta e Credito*, No. 117, March 1977, and "The Management of an Open Economy with '100% Plus' Wage Indexation", in *Essays in International Finance*, Princeton University, No. 130, December 1979.

and inflation targeting but also improving the mechanisms of monetary circulation, instituting reliable and efficient infrastructures, and what is now called "transaction banking". In a market economy the costs of a dysfunctional payment system could be just as great as those deriving from volatile inflation rates. This was particularly evident in Italy, where at the time the settlement of cheques or the completion of a credit transfer were long and cumbersome processes that involved a fragmented set of bilateral arrangements among banks.

The reforms that Tommaso Padoa-Schioppa promoted at the end of that decade successfully bridged the gap between Italy's system and that in place in the other major economies. In a first phase, from 1989 to 1993, the reform involved the system for netting in central bank money, with the launch of dedicated projects for various payment types (customer paper-based and electronic, inter-bank, foreign exchange, securities trading). He then promoted a national, centralised real-time gross settlement system in central bank money that exploited the most advanced technologies and that would quickly make central banks the leaders in this sphere. Eventually, the system was adapted to be fully integrated into the network of euro-area payment systems (the TARGET structure).

In parallel with these architectural and technological developments, Tommaso forged an intellectual environment that produced important economic research in the field of payment systems that now enjoys worldwide recognition. At the time he was deeply involved in the process of European monetary unification and soon realized that the creation of a single currency would have to be accompanied by the institution of a unified mechanism for its circulation throughout the European economy. A workshop that he organized at the Bank's conference centre in Perugia (SADiBa) in November 1991 revealed how fragmented the procedures and mechanisms of the various European countries were and paved the way for the payment system agenda of the years following. From 1991 to 1995 Tommaso chaired the Working Group on Payment Systems of the central banks of the European Community; he resumed this project when he joined the Governing Council of the European Central Bank. In that position he promoted a revolutionary arrangement by which each country would delegate the large-value settlement of inter-bank transactions to a centralised system run by three central banks on behalf of the entire Eurosystem. This is how TARGET was revolutionized, transformed into a highly efficient, secure single shared platform for the benefit of the European financial system (TARGET2, created and jointly managed by the Bank of Italy, the Deutsche Bundesbank and the Banque de France). His worldwide leadership in the area of payment systems received an important recognition when he was nominated Chairman of the Basel Committee on Payment and Settlement Systems, a position that he held from 2000 to 2005.

Europe's resolve to fight inflation and enhance monetary stability was at the basis of the establishment of the EMS in 1979. With the Single European Act of 1985, it was decided to form the "single market" and to fully liberalize capital movements and foreign exchange transactions. The European Council meeting in Hannover in 1988 created the Delors Committee; through a surprisingly smooth and rapid process – even if at the time it seemed time-consuming and rather complex – this led to the Treaty of Maastricht and, eventually, the EMU. We all know the crucial role, intellectual as well as practical, that Tommaso Padoa-Schioppa played in this process, as joint secretary, with Gunter Baer, to the Delors Committee. I needn't add much to this, save to recall a couple of issues.

I am sure that if we ask even well informed people what the initials "EMU" stand for, we will hear, most of the time, "European Monetary Union" as an answer. Actually, of course, it is "Economic and Monetary Union". From 1979 to 1983 Tommaso was, as I recalled, Director General for Economic and Financial Affairs at the European Commission. In that capacity he oversaw the initial operation of the EMS and was certainly instrumental in paving the way to the actions that would lead to the Single European Act.[6] But he was persuaded, from the analytical perhaps even more than from the political standpoint, that "the EMS is not enough", and that the full implementation of the programme set out in the Single European Act would give rise to an "inconsistent quartet" in an area characterized by free trade, full capital mobility, fixed (or managed) exchange rates and national monetary policies. (This thesis, without explicitly setting the condition of free trade, had already been set forth in the literature, as a dilemma or an impossible trinity, by Robert Triffin and others).[7]

I said "from the analytical standpoint", but I might have also said "architectural". I believe that Tommaso's ambition, and the founding role that he played in this process, from the initial ideas to the (indirect) negotiation of the details of the Treaty articles and the actual establishment of the Union, was exactly to create a proper institutional set-up for an idea of Europe designed to improve the well-being of its citizens and ensure fruitful interaction with the rest of the world. At times, there is criticism of what can be seen as a "technocratic" approach to political union. But Tommaso was well aware of what he called the ambiguity, in the development of Europe, "between a purely economic project and a political project, between confederation and federation, between a free-trade area and a single market, between technocracy and democracy, between Jean Monnet's functionalism and Altiero Spinelli's constitutionalism".[8] He understood very well the risk of a "democratic deficit" and the limitations of "a currency without a State".[9]

So Tommaso Padoa-Schioppa has been widely identified as a (if not *the*) "founding father of the new currency," "architect of the euro". I believe that this is proper, but I wanted to emphasise that Tommaso was also deeply convinced of a notion clearly expressed by James Tobin, namely that as "Policy and structure become inextricably combined, their joint product is what matters. … One way to alter the operating properties of the system … is to change the policy rule. Another way is to change the structure".[10] And it was to changing structures that he devoted much of his intellectual and professional life.

For several years, while still at the Bank of Italy, he was Chairman of the Basel Committee, where he initiated a process that would lead to what came to be called the "Basel II" Accord. The regulatory system was built around the basic notion that banks should set aside capital to guard against the various types of risk: credit, market, operational. The financial crisis has taught us that both the assessment of and the allowance for these risks were vastly inadequate. Tommaso recognized this. Still, he maintained that Basel II was definitely better than the previous accord precisely because it sought to specify in detail the various risks in banking and to provide, through its "three pillars" construction, a comprehensive framework to deal with them. He conceded that substantial changes at the technical level of the Accord were necessary, but he emphasized, in his Per Jacobsson lecture last June, that "what really went wrong is on the side of the government [which] was captured by the myth that finance can regulate itself spontaneously and hence retreated too much from the regulatory and

[6] See, on this, his book co-authored with Michael Emerson, Mervin King, Jean-Claude Milleron, Jean Paelink, Lucas Papademos, Alfredo Pastor and Fritz Scharf, *Efficiency, Stability and Equity*. *A Strategy for the Evolution of the Economic System of the European Community*, Oxford University Press, London, 1987

[7] See, "The EMS is not Enough: The Need for Monetary Union", 1987 (chapter 6 of *The Road to Monetary Union*, cit.), and "Squaring the Circle, or the Conundrum of International Monetary Reform", in *Catalyst, a Journal of Policy Debate*, Spring 1985.

[8] *The Road to Monetary Union*, cit., p. 22.

[9] See, finally, *The Euro and its Central Bank. Getting United after the Union*, MIT Press, Cambridge, Mass., 2004.

[10] James Tobin, "Financial Structure and Monetary Rules, in *Kredit und Kapital*, 2, 1983, quoted in "Reshaping Monetary Policy", cit. p. 283.

supervisory role that is necessary to ensure stability."[11] The financial market, that is, is a fundamental mechanism of our economies; but it is not an abstract concept. In the real world it appears as a complex infrastructure developed through a laborious process, with a set of well-specified rules of the game and the need for an attentive and vigilant supervisory system.

In the same lecture Tommaso returned to another recurrent theme of his, the need to move beyond the level of the "nation state" – in this case in order not to leave "the rapid emerging reality of global finance" unmanaged. And to the improvement of international cooperation and the reform of the international monetary system he devoted his last days, through the group that he convened with Michael Camdessus and Alexandre Lamfalussy – what is now called the "Palais-Royal Initiative".[12]

To conclude, Tommaso Padoa-Schioppa was a true leader, a man with whom it was always instructive to engage in a conversation, but at your own risk – always with the assignment, that is, be it explicit or implicit, of producing a concrete, real-world result. His professional life may well be compared to the work of a creative and passionate architect. He was not, and he did not pretend to be, "always right". But, like the builders of the medieval cathedrals that enrich Europe, he was a "man of vision," a believer but also a very practical man. He was loyal to the institutions which he served but no slavish follower of received tradition. He contributed substantially, through his example, his writings, his actions, to the advancement of our society. He worked tirelessly and effectively for a better country, a better Europe, a better world than the one into which he was born.

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[11] "Markets and government before, during and after the 2007–20xx crisis", Per Jacobsson lecture, Basel, 27 June 2010.

[12] Palais-Royal Initiative, "Reforming the International Monetary System. A Cooperative Approach for the Twenty First Century", Paris, January 18, 2011.