



## Lessons from the Crisis: Challenges for the Advanced Economies and for the European Monetary Union

Jean-Claude Trichet, Former President of the European Central Bank

Eleventh Annual Niarchos Lecture

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*Unedited transcript*

C. Fred Bergsten: Let me welcome all of you very warmly this evening to our Peterson Institute for International Economics, for the eleventh annual Stavros Niarchos Foundation lecture.

This is a program sponsored by the Niarchos Foundation, to whom we are very grateful, which enables us every year to bring a world-class leader, thinker, or both, to our podium to discuss a hot issue. Now this year, we were obviously incredibly prescient. Because we chose the Euro as the topic, knowing that there would be some episode of the crisis that would make it particularly timely.

And we were doubly prescient by convincing Jean-Claude Trichet to come and be our speaker, since no one, literally no one could do a more thorough and intense job on that topic than the man who was head of the European Central Bank for the previous ten years until stepping down last fall.

We are grateful to all of you for coming, and we're particularly grateful to Jean-Claude. We do view this evening, both the lecture and particularly the dinner following it, as a tribute to Jean-Claude for the enormously productive, successful, courageous career that he has exercised in his native France, in Europe as a whole, and for the world economy in many, many different regards.

So I will first introduce Andreas Dracopoulos, the co-president of the Stavros Niarchos Foundation, to give a few words of welcome from the Foundation. I will then turn to the chairman of our institute board of directors, Pete Peterson, to introduce our speaker for the evening, Andreas.

Andreas Dracopoulos: Distinguished guests, ladies and gentlemen, good evening. First of all, I would like to thank Fred Bergsten for his kind words and for all the amazing work that he has done and he continues to do for this institute. It has always been a pleasure working with Fred, a pleasure and a privilege.

Thank you for joining us today for the eleventh annual Stavros Niarchos Foundation lecture series. It all started back in 2001 with esteemed chairman Alan Greenspan, who is with us today, as our first speaker. And eleven years later, the series continues with Mr. Jean-Claude Trichet, who after 40 years of an exceptional career as a public servant has accepted our invitation to share with us his experiences and most specifically to speak about the lessons learned in relation to this ongoing crisis that the developed world, starting in Europe, is still facing as we sit here this evening.

The challenges are great. Sometimes they even seem to be insurmountable. Perhaps nobody knows for sure what we will have to go through until we really recover in a sustainable way. But the crisis will surely become insurmountable if we all continue to be so polarized by sticking to stubborn and fixed views about everything and anything, from global warming, stem cell research, to taxes and entitlements, to deciding either/or, either austerity or growth.

Which by the way, they're not mutually exclusive, and if well thought out, they both belong in the ultimate solution. This mentality of extreme polarization at the end of the day effectively makes us all unable to really learn any lessons. An inability to learn and collaborate in trying to find solutions, and yes, sometimes to reach necessary compromises, will certainly make these challenges impossible to address and will probably mean much more pain for all of us and for our children.

Institutions like the Peterson will keep playing a vital role in hopefully depolarizing us all. We are thankful to the Institute for making available to all of you this evening our Niarchos Foundation's latest booklet, describing our most recent ground-breaking activities around the world. And without wasting any more time, I'm honored, on behalf of my colleagues at the Stavros Niarchos Foundation and Spyros Niarchos who's here with us tonight, to mention the honorable public servant, Jean-Claude Trichet. Hope you enjoy the evening, thank you for all joining us tonight, and Pete will do the formal introduction. Thank you.

Peter G. Peterson: Before I say a few words about our guest of honor, I would be deeply remiss if I didn't say a few words about Fred Bergsten. As you probably know, he has decided to retire from his position as Executive Director of this Institute, but thank God he is going to stay as a Senior Fellow and do research and writing.

And Fred, my mind goes back to nearly 32 years ago when you and I were refugees or victims of the Nixon administration and I was President Nixon's assistant for economic affairs and you were Kissinger's economic advisor. And when we got out of those positions, we were lamenting the fact that in spite of the obvious growth and importance of international economics, not only in economic matters, but in foreign policy matters, there was no important place within the United States where this had deep capabilities. At that point, we joined with Frank Loy of the German Marshall Fund who wanted to build something in the United States, out of gratitude perhaps for what America had done for them, and this small institute was started. Thirty-two years later, I got great satisfaction, and I hope you got some pride, Fred. I'm seeing that a British magazine asks a large panel of experts which are the best think tanks in the world, and this rather small institute was picked number one from hundreds or thousands I guess, Fred, of think tanks.

Now, I think you test the outer limits of compound probabilities. Let's indicate what I mean by that. You are extremely good substantively and in defining a creative agenda that gives us a comparative advantage. You're supremely good at attracting the very best people, and not only attracting them, but keeping them. We've had remarkably little turnover here, it seems to me. You're very good at outreach and communicating the results to the relevant audiences, the Congress, and the public at large, and business, and so forth. How many corporations do we have now that support us? 150 different corporations, just a remarkable piece of work.

And I always used to needle Fred that I didn't want him to forget this trivial subject called fundraising. And he almost carried it too far. I reached a point where I was terrified to approach him because his capacity to get into my pocket, even when my hands were in my pocket was simply extraordinary.

So I could go on and on about a combination of qualities. But I consider you, Fred, a one-in-a-million head of an organization like ours and you ought to be very, very proud. And if I may prevail on you, if anybody deserves a standing ovation, it's Fred Bergsten, and I'd like to get that.

C. Fred Bergsten: Thank you all very much. Deeply appreciate it, thank you.

Peter G. Peterson: I used to say to Fred that total compensation is made up of financial compensation and psychic compensation, and that we were very good at psychic compensation. We weren't nearly as good at financial compensation and he's been able and willing to accept a modest income for somebody of his talent.

Well, back to our program this evening. We at the Institute, again, want to thank the Niarchos Foundation for making all of this possible. We're either, as Fred indicated, extremely prescient or very lucky. I say there are two kinds of luck in this world, smart luck and dumb luck, and I'll take either one. But we choose to think that Fred was prescient in this case.

Nor could we have gotten a more knowledgeable speaker than Jean-Claude Trichet. He of course played a decisive role in the Europe crisis as president of the Europe Central Bank until he stepped down last fall. This was only the latest episode in Jean-Claude's remarkable career as a top economic policy thinker in France, in Europe, in the Eurozone, and in fact the world economy.

Jean-Claude began his career at the French treasury and rose to become director in 1987. During that period, he played a lead role in steering the franc towards exchange rate policies and restore the country's economic strength and stability. He had continued these efforts as Governor of the Bank of France for two terms, which he did from 1993 until 2003.

While in that position, he prepared a pivotal role in the creation of the Euro itself and was a member of the Convening Council of European Central Bank from the onset of the new currency. He became president of ECB in 2003 and ended his single eight year term last October.

Jean-Claude has received so many honors and accolades around the world that I cannot begin to list them all; they are given in your program. Most important, of course, has been his role as a member of the Board of Directors of the Institute.

I thought that was rather funny, but apparently not. He's been a director since 1998. It is a great pleasure and an honor to introduce Jean to you to give this year's Niarchos lecture. Jean-Claude, welcome sir.

Jean-Claude Trichet: Thank you so much. Thank you very, very much indeed. I must confess it's an immense pleasure and very great honor for me to be there with you Pete, with Fred, and I have to

say, with all the friends that here, that are your close friends and also my close friends. I have to say I am very moved to deliver the lecture for the Stavros Niarchos Foundation.

I understand, Pete, your family is coming from Greece? The Stavros Niarchos Foundation seems to me to be close to Greece, too. And when you were speaking of lucidity or extra lucidity in choosing the issue for this lecture, I have to say that you really were very lucky, as you said. I don't know whether it's good luck or what kind of luck you were mentioning, but Greece is at the very center of global attention today. I will try to put into perspective a part of what we are observing at the very moment.

I would also say that it's an immense pleasure to be here with Fred. I know Fred; I have been knowing Fred since a very long period of time, since you were involved in the G5 meditation, very old times, obviously, where we were speaking of the G5 and not the G7 or the G10 or the G20 or more. And my memory is that we have been in very close contact, particularly in the occasion of all the crises that we have experienced at a global level over the last 25 or 30 years because we are experiencing a crisis in the advanced economy since five years.

But we were together in the crisis of Latin America and in the crisis of Africa and in a number of other crises. I always appreciated enormously your lucidity, your imagination and we shared, at certain moment, imagination to try to get some events in the international community, or new concepts and your fantastic energy, which is legendary.

As I said, we have witnessed together the Latin America crisis, the African crisis, the Middle East financial crisis, culminating with the Egyptian bankruptcy in the '80s, all this in the '80s: the Central and Eastern European crisis culminating with the Polish collapse; the Soviet Union, financial crisis, culminating with the Soviet Union dislocation at the end of the '80s and the beginning of the '90s; the Asian crisis at the end of '90s. And the advanced economy financial crisis since mid-2007, with a number of episodes, and now we are in this particular episode where the European Union, and more particularly, the Euro area is the epicenter of the present episode of the crisis.

If we put the present crisis in this perspective of the 25 or 30 last years, the fact that the advanced economy were hit starting in '07-'08 is less surprising then we are practically the only ones that were spared from adjustment since World War II. Practically all the other countries and economies in the world were hit earlier. In a way, it was their turn and I have to say, what a dramatic turn.

It reminds me, I'm speaking in front of a previous Chairman of the Fed, and Don, who's here. I remember Ben telling me, at the moment where the epicenter of the crisis was crossing the Atlantic at moment where we were just starting to experience the crisis of the sovereign risk, Ben put his finger on me and said, "Now Jean-Claude, it's your turn."

Which was a very good summing-up, unfortunately, of the situation. It was at the end of '09 and at the beginning of 2010. I am personally convinced that these 2007-2008 initial shocks were potentially even graver than those which triggered in the '29 crisis. Had the central banks and the public authorities not embarked on prompt and decisive actions, I trust that we would have experienced not only a great recession, but a dramatic, deep and rapidly unfolding depression that would have been, again, graver than in '29. That is my personal understanding of the situation we had to cope with.

But the central banks and the public authorities embarked on prompt and decisive actions. And by public authorities, I mention not only the states and the main participants in the international community and also the international financial institutions.

Let me say that I would concentrate my own exposition, if you permit me, and you will have a written paper that would be a little bit longer, but I want to let some time for the questions, and I understand, Peter and Fred, that it is your intention to organize some question and answer session. But let me only say that I will first concentrate a little bit on monetary policy in the crisis and the so-called nonstandard measures which were a part of these prompt and I trust, decisive action that the central banks had to engineer in order to cope with this extraordinary crisis.

And second, I would concentrate on the Euro and the future of the European economic integration. Let me say, on this particular issue that it reminds me of story, in fact that we are so numerous here to listen to what I have to say on the Euro in particular, remind me of a story in 1996 of this European academic that was invited in the United States of America to participate in a colloquium on the yuan.

At the time, you know, the yuan was not interesting; it was not a fashionable issue. So he was a little bit surprised nevertheless to see that at nine o'clock, which was the supposed start of the colloquium, there was absolutely nobody in the room, so he waited a little bit, 20 minutes afterwards, one person entered and he understood that he could not expect much more audience.

So he had prepared his own exposition, he had a lot of slides, he embarked on a one-hour exposition and he was—he got meager applause, as you can imagine, and he was re-packing everything and leaving the room when the guy in the room said, “Sir, sir, don't leave the room. I am the next speaker.”

Well, as I said, it's much more fashionable, for a very bad reason, so obviously today. But let me first say a few words on the unconventional measures. The widespread introduction of so-called “nonstandard monetary policy measures” by major central banks has been a defining characteristic of the global financial crisis.

Across central banks, there has been no standardization of non-standard measures: approaches are distinct, tailored to their respective economies and their structures. We have seen enhanced credit support, credit easing, quantitative easing, interventions in foreign exchange and securities market and the provision of liquidity in foreign currency.

And let me say, in front of Alan and Paul and also Don, that we have enormously appreciated the cooperation between the Fed and the European Central Bank at the heat of the crisis, the cooperation, the fact that we could have an agreement and a swift agreement to issue ourselves the dollars in Europe (of course at our risk and with the appropriate collateral that we were controlling ourselves), but has played a decisive role I trust, at the very moment where the global crisis was culminating, the financial crisis was culminating. So again, a very, very, very profound thank to the Fed in this occasion. By the way, I think that without the mutual confidence that the major central banks had at all levels, with the staff level and top level, has been decisive I trust in the handling of this crisis and I think that it is under-assessed, underestimated, that degree of mutual confidence.

Anyway, these nonstandard measures have been used to support the functioning of the financial sector and to prevent the real economy from the fallout of the financial crisis as much as possible, and also, ultimately, to preserve price stability over the medium term.

There are two distinct views of nonstandard measures. Some view the nonstandard measures as the continuation of standard policy by other means. Once nominal interest rates cannot be lowered further, central banks use other tools to determine the monetary policy stance that is to contribute in the desired way to economic, financial, and monetary developments.

To illustrate this view, I would compare it to, once the end of the road has been reached, engaging the four wheel drive. Central banks expand their balance sheets and inject liquidity so as to influence the structural [inaudible 0:25:28] and returns and thereby stimulate aggregate demand. This approach would be broadly in-line with the theoretical analysis and prescriptions of Friedman, Tobin, or Patinkin.

The logic of this approach is essentially sequential. First, the standard measures, then the nonstandard measures. If the sequential logic were also to be applied to the exit, it would essentially mean unwinding nonstandard measures first and subsequently raising interest rates.

Let me suggest a different view of our nonstandard measures. Say that key interest rates are to be set at levels we consider appropriate to maintain price stability going on our regular comprehensive assessment of economic and monetary conditions. In other words, in this perspective, policy makers would follow standard practice in this regard. Their interest rates can be more or less significantly positive, close to zero, or at zero-level, on the basis of this analysis. But whatever the level of nominal interest rates, on several occasions, particularly in time of acute crisis, the monetary policy stance established in this way faced obstacle in being transmitted to the economy.

During the financial crisis, market functioning was impaired at times very profoundly. In response, one might act to overcome some severe malfunctioning that was hampering the channels of transmission of monetary policy. In this perspective, nonstandard measures would be introduced to help restoring a more effective transmission of our monetary policy stance to the wider—in the case of Europe, the wider Euro area economy.

Staying with the image of the road, I would say that the metaphor suggests to remove the major roadblocks in front of us so that the policy stance could be transmitted to the economy in the intended way, whatever the level of interest rates would be. The logic of this approach is therefore parallel and supportive.

This logic has a potentially clear implication for the exit. In this perspective, we can determine standard and nonstandard measures very largely independently of one another. Policymakers will not be bound to unwind nonstandard measures before considering interest rate increases or to put interest rates to the zero level before considering the introduction of nonconventional measures.

In this perspective, it would be legitimate to take those decisions independently. One set of measures, the so-called standard ones, depends on the medium and long-term

outlook for price stability; the other, the nonstandard, depends on the degree of the dysfunctioning of the monetary policy transmission through the financial system and financial markets.

With this overview of the guiding principle in mind, I would to discuss perhaps a little bit in detail what is at stake in this area. I have to say that the changes in the ECB's key short term interest rates, the so-called standard policy measures, have remained the key instrument of monetary policy in the Euro area and I trust that the governing council has always put the rates at the level which was deemed appropriate for the delivery of price stability over the medium term.

And I would say that two issues are worth particular attention: first, the close relationship normally observed between the key policy rate and short term money market rates assumed a more complex form during the crisis. And it was important to recognize that in times of crisis, a broader set of market interest rates, extending beyond the very short term money market rates was relevant in signaling the monetary policy stance, given the segmentation of financial markets.

The second point I would like to highlight concerned a question of forward guidance or pre-commitment regarding the future path of key ECB interest rates. There is the sentiment in various places that we are in two different conceptual schools on the two sides of the Atlantic and I don't trust that it is really the case. I think that it is almost entirely a question of semantics, and of presentation. One school stresses the central bank view on the probability of realizing a certain path of short term interest rates over a considerable period of time. For instance, the high probability of having very low interest rates until 2014.

The second school stresses the importance of preserving price stability over the medium and long term in line with the definition given by the central bank. In the second concept, one also stresses explicitly the goal of having the low path for an important other indicator; namely, the stability of low, medium and long term inflation expectations in the years to come.

There is no doubt in my mind that the commitment on low interest rates for a considerable period of time is conditional. Normally, we'd trust that interest rates can remain very close to zero-level or at zero-level, whatever happens over a period of several years.

By the way, I have to say that it's always underlined by the central bank of the first school if I may, particularly by the Fed, that the commitment is not unconditional. It's been said very clearly by them in many occasions. It goes without saying that when one stresses the stability of long-term inflation expectations over time, it means that the interest rates of the main re-financing operation of the central bank of the second school say the ECB would be designed to deliver this stability, taking into account the changes that might occur in the economic and financial environment. So in both cases, short term interest rates can move and should move depending on circumstances.

We have, as you know, on our side of the Atlantic, preference for the second school posture of no medium term pre-commitment on interest rate. But again, as I said, I don't trust that it is a real conceptual divide; I think it's a question of how you present

more or less the same overall goal which is to pursue nominal and real interest rates favorable to growth which is of course depending on the nominal interest rates. And when you are pursuing a low level of inflation expectations of the medium and long run, you are paving the way for low, medium, and long term nominal rates.

Now, let me mention a little bit that a standard monetary policy proved, obviously, insufficient in the very challenging context of the financial crisis. I already said that we had considered that standard measures and nonstandard measures should not be coupled in our own case and as you know, we have, obviously, had the 9th of August 2007, we embarked in the first nonstandard measure that where in the case of the Central Bank of Europe, really this ill-limited supply of liquidity at fixed rate, at different duration, and provided of course, appropriate collateral was presented. At that time, it was a very short duration; it was a 24-duration, but it was a ill-limited supply of liquidity at an interest rate which was 4.25%. It was the interest rates that was the main re-financing operation rates, the 9th of August 2007. And so, clearly, our first try of nonstandard measure was particularly clearly not associated with a zero-bound level of interest rates, but again, a very substantial one.

So it was the best illustration I can offer, at the very beginning of the nonstandard measure of the way we are looking at it. Now, I have to say that the nonstandard measures, as far as we see it, I see it, are of course something which is very abnormal, obviously, and that must be associated with a number of conditions.

I will go very rapidly on that, but I think it's important to realize that if they are not very carefully monitored, the nonstandard measures might have themselves the unintended consequence of creating a functional environment which could be abnormally benign for private markets, for commercial banks, and of course, particularly in our case, for sovereigns.

This in turn, could contribute delaying the necessary improvements in rules, regulations of the financial sector, balance sheet repair of financial institutions, structural reforms of the various national economies and of course, fiscal adjustment. This is true, I would have to say, in all advanced countries, and it is particularly true in the European case.

That the reason why it seems to me that nonstandard measures satisfied the five following conditions. First, they must be as precisely commensurate as possible with the degree of dislocation and disruption of market; they must contribute to counter. It's of course always a matter of judgment and of course, for a judgment, an initial diagnosis which would be as lucid as possible.

Second, the measures must be accompanied by messages as forceful as possible to commercial banks to urge them address resolutely their medium-term recapitalization and balance sheets repair issues. To the extent that banks are by far the main instrument utilized for the nonstandard refinancing in the case of the ECB, this message is particularly important in Europe. This calls also for the messages of the central bank to be fully understood and correctly transmitted by the supervisory authorities in each particular jurisdiction.

I have mentioned the fact the nonstandard measures were of a different nature in the US and in the Euro area; the reason is very, very simple and it's clear cut. It seems to me

a very convincing explanation. In our case, the financing is made by commercial banks with the proportion before the crisis of approximately 75% against 25% financed by the markets. And it's not surprising, therefore, that we have concentrated our nonstandard measures on the commercial banks.

In the case of the US, it is exactly reverse. Before the crisis, the financing was done by the markets in the proportion of say 75%-80% and the banks for the rest. And of course, not surprisingly, the nonstandard measure of the US Fed is concentrating on markets and we are both, I would say, combating what could be the worst possible case. In our case, I would say the sudden stop of the functioning of the commercial banks channel to finance the economy in the US. The sudden stop of the markets themselves to finance the economy and we know that it is not only theory, but also at times, a very acute crisis, a risk which could have materialized.

Third, the conditions, the measures must be accompanied also by clear and unambiguous messages when and where needed to the countries themselves. When the nonstandard measures are necessary, in particular because of destruction of markets due to a loss of confidence in the sovereign signature, the messages must be as clear and quick as necessary in order to avoid the failure of the measure themselves and of the creation of an artificial environment that would pave the way for major additional difficulties in the future. A case in point would be the messages that were sent in August 2011, by the ECB governing council to several governments in Europe and the messages sent in the most recent experience of the so-called three-years LTRO to all governments in Europe.

Fourth, in the case of Europe, an additional condition would be to ask the European institutions, as well as the governments, to embark collectively on a significant improvement of their economic governance. What I call myself "the quantum leap in improving the economic governance." I will go back to that. And it is absolutely clear that this was one of the very strong message that the Central Bank had for the European institutions namely for the commission and the council, namely the government as a grouping.

And fifth, I think I trust and I daresay that in front of the Fed representative, the previous chairman, I think that the last condition remains very important to the extent that the combined nonstandard measures of the central bank of the advanced economy are creating at the global level a very substantial structure of change in the monetary and financial environment of the global economy; it seems to me necessary for the full constituency of central banks to call for the appropriate reinforcement of global governance, not only continental governments as in Europe. As long as the nonstandard measures are considered necessary by central banks, I'm convinced that they are entitled to be the most vocal advocate of the necessary reforms of global finance and the necessary adjustment of global imbalances through appropriate changes of the macro policies within the framework of the G20 and with the decisive contribution of the international, financial institutions.

I have to stay and I don't want to embark more on that, that the decisions, which was taken by the ECB as regard to the last LTRO, meets all the five conditions I have mentioned. The commensurate: it was commensurate to the gravity of the disruption of markets, and all the other conditions I have mentioned were there, too. So I have

absolutely no doubt that this was an appropriate decision to take. I mentioned of course the fact that this is—these conditions, these messages, are part of the decision that which was taken. Now, I have to say that I don't want to embark too much on some kind of meditation on what exactly is happening, but I draw your attention, and we are in a sanctuary of meditation, if I may, here. Economic and financial reflection. And it's hard to imagine a better place to open up avenues for reflection.

For me, it's absolutely extraordinary that the major central banks of the world—all the major central banks of the world have, at the present moment, at the moment I'm speaking, embarked in nonstandard measures that have the consequence of augmenting considerably their balance sheets. I have the computation of some metrics to understand exactly what is the volume of this new intermediation which is done by central banks in the US, in the UK, in Japan, and in the euro area.

The figures I have, as regards the volume, in terms of percentage of GDP of the balance sheet augmentation, which is due to monetary policy—I found, since the start of the crisis, say pre-Lehman up to now, an increase of around 10% of the GDP for the ECB, 12% of the GDP for the Federal Reserve, something like I would say 12% also for Japan. The volume, the overall size of the balance sheet, are not the same from country to country. Some, like Japan, had embarked in nonstandard measures long before us. Others have a big capital and oil funds, which is the case of the ECB. Others have no real big capital. But all taken into account, we are more or less in the same situation, with more than 10% increase of the intermediation by central banks in all advanced big economies.

And so we have to try to understand better what it means exactly. And I have to say the most striking observation is that it seems that it is something which is considered now, very likely to stay for a certain period of time. I don't know whether I can use the word "considerable period of time," but it is more or less what it is understood and accepted, more or less, by observers.

So it remains strange, obviously. Nobody had imagined that it could be the case. Ex ante, there was absolutely no model suggesting that a certain moment, we would have to substitute to a normal functioning of the private sector, which is obviously the case. And what is even more striking, is that it is an observation that you can make in all big advanced economy.

So I was mentioning the fact that all other economies, had to, at a certain moment, to adjust—we have to adjust. But one of the consequence of this stress in which we are all placed, obviously, it is precisely that the central banks are in that situation.

I don't want to, again, do anything but opening up avenue. We have two major explanation, and I hope very much that the first explanation would appear to be the right one. In this first conjecture, which has to be proved, we would be experiencing a transitory phase in the advanced economy as a whole. We need now a significant level of nonstandard measures to give time to the other partners, and I've mentioned the other partners when I listed the conditions: the private sector, the sovereign themselves and governance at the continental level and at the global level, so we are letting them the time to adjust and to permit the exit.

Another explanation, which I don't like at all, but which I feel might explain why it is such a long period because after all, the crisis started five years ago, and Lehman Brothers is already something which happened a number of years ago. Maybe we are now combating an emerging property of the new global financial system which we have to better understand.

Perhaps there are the possibility of tail risk of total disruption of the system, provided some conditions are met as we have observed, obviously, immediately after Lehman, where we had an immediate, grave and immediate threat of collapse of the entire system. Or more recently, in Europe, at the moment where the ECB had to step in because there was, again, the grave and immediate threat of a sudden stop of the functioning of our banks.

So this new systemic risk we have not observed before, and I hope very much that will prove that it was only because the macro policies were not correct, because the imbalances (and I know Pete to which extent, you yourself are pointing the finger on imbalances, domestic and external), and that provided, all these imbalances are corrected, provided, rules and regulation in the financial sphere are correctly designed, we would eliminate this risk.

But there are other theses, according to reach the level of interconnectedness between all participants, financial institutions, market participants in general has dramatically changed with technology and with globalization. And that therefore, we have new tail risk that are calling the central bank to play a new role. And again, as I said, I hope very much that this conjecture would prove wrong. But this is something on which we could work and we have to work, obviously, because we have to understand better what happened exactly over the last five years.

Now, let me say a word on the European integration and the future of European integration. And consider that it is a way to open up the floor for discussion. First of all, I have to say that the EMU, Economic and Monetary Union, is an acronym, which means, again, an economic union on the one hand, a monetary union on the other hand. There is a tendency to confuse the two concepts. And I think it's wrong because then you don't understand exactly how you can have a solid currency at a moment where you have such problems of financial stability at the level of the sovereign and by way of consequence, at the level of a number of financial institutions.

On monetary union, I dare embark on a thought experiment. Consider that if I was not making [inaudible 0:50:11] of monetary union, you would probably be very, very surprised. So I'm sure that you will forgive me to tell you the following.

Had I told you, at the invitation of the Peterson Institute, in '98, say at the end of the first quarter of '98, "The Euro will be set up in time and without technical problem," I guess that 50% of the audience would have trust me and 50% would not because it was very, very frequently argued that it was too bold and that even the technical aspect of the monetary union were much too bold.

Had I said that 13 years after the setting up of the Euro, from January '99, there would be 332 million people with the Euro and 17 countries, I guess I daresay that only 10% of the audience would have trusted that it would be possible. But 90% would have

said, “He’s dreaming. Three hundred and thirty two million is more than the US; he’s dreaming. He’s very involved, of course, but he’s dreaming.”

Had I said that the price stability would be delivered at the level of 2.03%, I guess that 1% of the audience would have trusted me and the other one would have said, “Okay, he’s a central banker, he tries to be as convincing as possible, but it’s of course, a dream.”

Had I said that it would be better than any big central bank, including the Bundesbank, over the last 50 years, it would have been considered possible by 0.05%. A fraction of a person.

And again, had I said that the same price stability would be considered credible by markets for the next ten years, and the same or even less of a fraction—a small fraction of one person, if I had said that 13 years afterwards, the exchange rate would be higher than the introduction with the US dollar and the sterling pound. And I don’t make an argument on that; I only mentioned that, but I would certainly not suggest that because we are in a floating exchange system. But it is what I observed today.

Had I said that all this still was still observed five years after the worst crisis ever since World War II, zero person would have said that, and even me, I would certainly not dare say that five years after the start of the worst crisis since World War II, we would be in such a situation. So I don’t say that to be complacent, I don’t say that to, I would say, suggest that we have no problem; we have enormous problems. All of us, particularly us, the Europeans, have enormous problems. But have that in mind, have that in mind nevertheless because we are permanently plunged in an environment which is a little bit biased, which I can understand because all this is very bold. And that the proof of the matter is that this thought experiment shows to which extent it was bold to say that.

Now, let me also mention two points that are totally ignored, but might be of some interest in the real economy side. Since the setting up of the Euro, 1st January ’99, do you know what is the level of growth per capita in the United States of America and in Europe? I will give you, per capita. 0.8% in Europe, Euro area. 0.6% in the US. Not entirely fair because growth was very buoyant in the US over the ’90s and of course, the period is not fully comparable, but I have a tendency to compare because it is very often said, “It’s because of the Euro that you are growing so miserably.”

So let’s take the start of the Euro. And fortunately, nobody is—yeah, some are standing up, because I have to stay you have stay on your chairs when I mention a second set of figures.

Do you know how many net jobs we have created in the Euro area, and in the US, since the setting up of the Euro? You will hear 14.5 million, until the end of last year, so taking into the account the crisis. United States of America, 8.5. So I was so surprised by the figure, I said that I call upon you to check. 1st January ’99 up to end of 2011. I was very surprised. So only to mention things that are also illustrating the fact that we don’t see exactly what is behind.

But I said, I don’t want to be complacent. Part of the results in per capita computation comes from the demographics in the US that are much better than in Europe. And it

is an asset for the US and it is a liability for Europe: that is absolutely clear. And for the job creation—again, job creation in '90s have been fantastic in the US. So it's not totally abnormal that there has been some relaxation since the setting up of the Euro.

But I draw your attention the fact that it is not known, nobody knows that. If you would ask people, and not people in the street, but people that are very enlightened, they would not even imagine that it is the case. So again, we have to understand that we are in a universe which is a little bit biased.

But that being said, we are the epicenter of the present crisis of severe risk. And I would say that economic governance has been very poor and miserable and has proved into crisis has been constantly behind the curve in Europe; that's the reason why we have asked ourselves, and I, personally, on behalf of the ECB asked for a quantum leap on the Euro area economic governance since the very beginning of the crisis.

I could sum up the bottom line in three propositions. First, economic governance was relying since the very beginning only on one pillar: the stability and stability and growth pact with fiscal rules, monitoring, and surveying of fiscal policies, and not on another necessary pillar: namely, the close monitoring and surveying of competitive indicators, domestic imbalances, and nominal domestic price and cost evolution.

And I have to say that this is in my opinion, absolutely of the essence, to have the second pillar which is now in theory, in the so-called new secondary legislation of Europe. Second, even the first pillar, the first single pillar, the stability and growth pact, insufficient in itself had been under attack of the major countries as soon as 2003-2004. And I say suddenly, because at that moment, France, Germany, and Italy were in the same very, very bad camp, namely try not to observe the stability and growth pact.

And third, there was no crisis management tools envisaged ex ante. Nothing at all. That is not surprising, very unfortunately, taking into account the generalized benign neglect demonstrated by advanced economy and the international community as a whole as regard the candid belief that the credit readiness of advance economies, sovereign signature, was not challengeable.

And I have to mention that this was really the mainstream consensus to the extent that the international—I am speaking at the Europe Control. A dear friend, the two successive managing director of the IMF, Rodrigo de Rato and then Dominique Strauss-Kahn, were told by the international community, "We don't need now any lending wing in the IMF. There is no point; private markets, private sector is there to finance sovereign, let's concentrate on surveillance." But we do not have to continue to have a lending wing, and it is only because the union of the IMF are much too powerful or influential that it has not been done already.

This was said until the start of the crisis and continued a little bit after the start of the first episode of the crisis after '07. So I don't say that to, I would say suggest, that the European were in good company, as regards absence of lucidity, but it is the fact that the entire international community had not foreseen what could happen in the '07 and '08 years. Not at all. And again, this is something on which I know you are working a lot here in Peterson.

Now, I have to say that we are all learning the hard way that we have to take all the possible lessons from the crisis. I think that as regards to the present situation, we have done some progress. First of all, the second pillar is accepted as absolutely necessary. Monitoring of competitive indicators and imbalances. It's part now of governance.

I have to say that they all have understood that benign neglect was absolutely impossible in the Euro area because of this X-ray of the crisis on the governance framework.

And third, I would say also that it is now fully recognized that crisis management tools are necessary and that they have to be up to the timing of markets and that what we had to do was to setup the crisis management tools through 17 democracies and fully respecting of course, the time of the democracies, which is not all the time of the market.

Now, let me concentrate on one point, which seems to me absolutely decisive. When I said that we should go further in the direction of a quantum leap of governance, which I trust necessary for the next step of European integration, I think really, that it means that in case—both I would say for the fiscal policy or for the economic policy having an impact on the competitive indicators—in case a particular country does not apply the recommendation which are coming from the center, through the commission and the council, and that—and it appears that it is impossible for that particular country to proceed, whether it is the will of the government, of the executive branch not to proceed or the will of the parliament not to proceed, then it seems to me we should have the activation of a federal governance by exception.

Not this kind of governance that you would expect all the time for a whole country, not at all. Highly exceptionally, but one country which cannot do the job, and then it should be in a treaty so that it would be fully democratic, that in that case, after a judgment made by the commission and judgment confirmed by the council, by the other countries, that—you know, I don't know, that particular decision should be taken. For instance, augmentation of VAT of X percent or in case there is an extraordinary dangerous move of nominal evolution, blockade of such and such, nominal evolution, that would be approved by European parliament.

So that you would have a full democratic backing at the level of representative of the people. But I would say, with full legitimacy, representative of all people of the Euro area, because they would all be at stake if there aberrant policies pursued by one particular country with an influence on all others. For me, it is not something which is of a different nature, in comparison with what we have already. Because what we have already is that in case that particular country is not applying the recommendation, it has to pay a fine.

So it is something which is very, very, at the limit of what you can accept. Your parliament is not behaving properly, we fine the country. Because the parliament has not voted the appropriate measures that are necessary for country X or country Y to be in line with what is judged by all Europe appropriate, not only for the country in question, but to protect the rest of the interconnected set of countries that are making up the single market with the single currency.

So I trust that this is something which we should be aiming at. And of course, we have,

under our eyes, the hard way to learn the lesson also, because we see to which extent it might be in certain cases complex, to be sure that we are protecting the full set of countries that are member of the single market with a single currency vis-à-vis a country which has real difficulty to take a particular decision or a particular set of decisions.

This idea of activating some kind of economic—not only fiscal, economic and fiscal federation by exception—seems to me not only necessary in the light of the present experience at the level of the, I would say, new step that we would have to do to be sure that we have a solid European union or a solid Euro area. I trust it might also appear as something which would fit with the very nature of Europe in the longer run. Because I don't trust that Europe is very likely to have an immense budget and I don't think that the budget of Germany is likely to shrink, the budget of France is likely to shrink in order to make room for the budget of Europe as a whole.

And so it seems to me that this idea that you let the various countries free to behave as they wish, provided they have the respect for a number of rules, but that there is always the possibility of activating the European democracy and particularly the European parliament, not only the intergovernmental council, if I may, but commission a council and parliament. And I think that this, I would say, solid democratic anchor is extremely necessary in the present period of time.

I must confess, that as president of the ECB and now Mario Draghi is—after being [inaudible 01:07:47] we all are doing the same. When we go to the parliament, very often, at least six times a year, to explain what we are doing and respond to all questions. Since the start of the crisis, it is in the European parliament that I could feel the best spirit of Europe. The best dedication for Europe that is really there, an entity which, in my opinion, stands ready to act and take the decision that I was just mentioning with, again, full dedication for super interest at the level of the full body of the countries concerned.

So I would stop there, so Pete and Fred, and thank you very, very much indeed.

C. Fred Bergsten: Pete, you want to start?

Peter G. Peterson: I'm going to start by asking questions from the audience.

C. Fred Bergsten: Well, I want to ask one first. Thank you for your kind words.

Peter G. Peterson: You're about not to be the executive director, so your authority is—

C. Fred Bergsten: I still am.

Peter G. Peterson: —far less than it was in the past.

C. Fred Bergsten: You can't kick me out yet.

I want to pick up a question on Jean-Claude's last and crucial point about the governance of the eurozone. You've made a very creative proposal, but we don't have it yet, and we have not had it through the crisis. It is therefore my conjecture that the ECB has filled the vacuum by functioning as the main governance unit of Europe. Most

dramatic case was when you and successor sent the famous letter to Prime Minister Berlusconi; it led to the change in government in Italy, it led to the change in policy in Italy, that is at least offering a prospect for recovery in that country.

But here is my question. On the view that it is the ECB that has functioned in the vacuum as the decisive economic governor of Europe, is it true that the goal of the ECB was not really to overcome the crisis, in any short-term sense, but rather to use the crisis to promote fundamental adjustment of the debtor countries, so as to put the Eurozone on a more long-term sustainable path. Obviously, you had to play that carefully so as not to trigger an apocalypse. I would submit so far you've done it pretty well. But the basic question: is the fundamental objective of the ECB acting for Europe to use the crisis, to try to strengthen the economy for the longer run?

Jean-Claude Trichet: Well, I would present the situation under a slightly different angle. We were, and are, the only executive federal institution; that's clear. We have single monetary policy, single currency; we have goals that have to be attained at the level of the Euro area as a whole. I mentioned already a number of those goals. Our primary mandate is to deliver price stability.

By the way, I mentioned the fact that the European public opinion is extremely attached to price stability. And all the public survey we did is demonstrating that there is practically no difference between the various public opinion. That is something which is also important. So the trust in the Central Bank depends extremely profoundly on this capacity to demonstrate that we have, as I said, a needle in our compass.

With that being said, being the only federal institutions in Europe, being the institution that could observe what was going on in the market at global level and European level, which is not easy to devise when you have another angle of vision and understanding, we had to play de facto a role of shipping messages permanently to governments and to other institutions.

That was part of our own positioning. We could not do otherwise. We were not dictating anything and it was always messages. It was—none of the message was when participating in the Euro group, we said, very clearly, that for us and for the treaty, the Stability and Growth Pact was absolutely essential at the moment where some governments were as I said, on a totally different line. And we were strong on that. Not imposing anything (we could not impose anything), but on the basis of our own analysis and understanding of the situation, I circulated myself and I'm sure that Mario is doing the same, the evolution of [inaudible 01:13:41] cost, evolution of a number of nominal evolution in the various 17 countries months after months, and saying, "Look, some of these evolutions are suggesting that some countries are going in the wall."

It was not in the treaty that we had to say that. It was not in the treaty that we had to mention to any particular government or to the Euro area as a whole, this kind of division because we are supposed to look at the Euro area as a whole.

And as I said, for the Euro area as a whole, we have delivered, obviously. But we considered it was also our duty to mention things that were of great importance for the cohesion of the system and were clearly in the camp of another responsibility of the

economic union. And it is true that we were in a situation where it was natural for us to do that. So I think we should not overdo our own influence; we were perhaps influential in some domain, very poorly influential in others, unfortunately, because had we more influential, perhaps we would have avoided some major difficulties.

All taken into account, it seems to me that we were clear enough in our own interaction with governments and with the European council and with the parliament. I mentioned the parliament as a major, major partner in all this period. We were clear enough that everybody could understand when we were already in our own domain of responsibility and decisions and when we were shipping messages to various partners.

C. Fred Bergsten: Follow-up question. How would you use the current crisis in Greece?

Jean-Claude Trichet: How would you use the present crisis in Greece? "You" being the ECB?

C. Fred Bergsten: Yes, to promote fundamental adjustment in Greece, taking into account the domestic political situation in which they find themselves.

Jean-Claude Trichet: I mean, the Greek case is very clear. You have the IMF and the IMF conditionality and the support of the international community, all countries in the world. You have the support of the countries of the Euro area and the conditionality which is totally coherent with the conditionality of the IMF; we participated as the ECB in the so-called troika in this work, but we take no responsibility ourselves in this negotiation, which is really the negotiation of IMF on the one hand and the negotiation of the commission backed by the council on the other hand.

And all what we have to do and can do is to back as strongly as possible, this idea that there is an absolutely necessity of [inaudible 01:17:01] to adjust because it's in the interest of the Greek people. It's in the interest of growth and job creation in the medium run and in any case, we are in a world where you cannot eternally spend more than you earn, as simple as that.

It is true for all of us. You cannot eternally spend more than you earn. All advanced economy in my opinion. Again, it's a crisis of advanced economy, and as I said, the other continent had to accept that at another moment, but we really are at stake, this is an exemplary case, if I may.

C. Fred Bergsten: So should the ECB stop supporting the Greek banking and financial system if they fail to reaffirm their commitment to the adjustment program.

Jean-Claude Trichet: The ECB will apply, as it has always done, its own rules.

C. Fred Bergsten: I take that as a yes.

Jean-Claude Trichet: The ECB will apply its own rules.

C. Fred Bergsten: Okay, Pete, we'll open it to the floor. Questions? Jacob. Please identify yourself; there's a hand mike coming around, or you can go to the two standing mikes. Identify yourself, where you're from, and fire away.

Jacob Frankel:

Thank you very much, Jean-Claude, for this fascinating reminder of that what is now self-evident and clear was not so a decade ago. My question really has to do with the sovereign debt. It may sound like a financial technical question but I think it's more than that.

As we know, today, sovereign debt within Europe has very large spread among themselves. Highlighting the fact that Greece is not Spain, Spain is not Italy, none of them is like France or definitely not Germany. Yet, for many years, the market failed to price those sovereign debt as being very different. The question is: first, what served as—what—why did it happen and what was the wakeup call? And second, during the many years in which sovereigns were viewed to be the same, critics argued that this served as an enable to irresponsible governments to continue borrowing with the market discipline because somehow the spreads did not come back to them. Where are we about it?

Jean-Claude Trichet:

I fully agree of course with your presentation. We have experienced a period of benign neglect that has been generalized in Europe. And I have to say, generalized in the world. The idea that sovereign risk in the advanced economy was totally eliminated was again the global consensus until the present crisis.

The formidable benefits that we can draw from such a big crisis, an intense crisis is that it is a scanner which permits to see exactly what other weaknesses and it's absolutely clear that now we have to consider that there is no sanctuary as regard to credit worthiness of the sovereign signature. There was no sanctuary in Latin America, or in Africa, or in the middle East, or in Central and Eastern Europe, or in Asia, now it's clear, the advanced economy themselves have to accept that they have to prove, maybe not today, but certainly at a certain moment tomorrow that they are on a sustainable pace.

Because at a certain moment, the investors and savers, would not accept to finance eternally an unsustainable pace which would be—is obviously, or has been the rule for a number of advanced economies. So my understanding is that under the dramatic shock of this crisis, we are now in a new world. And of course, that has a lot of consequence because if there is no ex ante full credit worthiness given by markets, by savers and investors the world over to the public authorities or the major public authority, we will not be able to block a new crisis of the dimension of the present one.

Let's not forget that—I mentioned because time is constrained, I mentioned the augmentation, the increase in the volume of the balance sheets of the central banks. But I could have mentioned the decisive action of governments. In the ECB, we have computed it seems to be that it was mid-'09, the total amount of taxpayer risks that had been put on the table on both sides of the Atlantic, to arrest the tsunami, the house of cards collapsing at the global level.

And all taken into account, you name it, the recapitalization, the guarantees of all kinds, the toxic assets, I would say decision taken by Congress and so forth, you arrive at a level of 27% of the GDP on both sides of the Atlantic. 27% of the GDP. Not challengeable for one second as good as gold by the investors and savers at the time.

The best example I have is Ireland. Ireland decides to guarantee its own banks. All the capital are going rushing out the continent of the UK to in Ireland, in Dublin with the

idea—the Irish signature is much, much better, of course, it goes without saying, than any private signature.

We are now in a different world. And I don't count—I count only the legal guarantee, the 27%. I don't count the blanked political guarantee which was given by whole heads of state and government of the major advanced economy, according to which a collapse of a systemic institution was totally out of scope. It was not a legal guarantee; it was blanket political guarantee but given by all heads of important advanced economy.

And that would represent 100% of GDP because the size of the balance sheets of these institution, the institution concerned was of course, gigantic. Again, not a legal guarantee, but a blanket political guarantee. So I really think that the window of opportunity that we have now to put our house in order, and I have to say, we have the sad privilege to be the epicenter of the crisis of the sovereign risk in the advance economy constituency, all this has to be done in an orderly fashion.

And if there's a question on austerity versus growth, I could respond, because it seems to me that it is part of the issue, of course.

C. Fred Bergsten: Caio.

Caio: Jean-Claude, I find your proposal of activating the federation by exception between council commissioned parliament very attractive. Particularly [inaudible 01:25:29] which I certainly believe, that fundamentally the origins and the evolution of the crisis is a crisis of governance in the European Union. The very poor interplay between the strong ECB, the strong leadership, and a weak commission, and frankly, a rather confused council.

So I wonder whether you could develop your thinking on governance strengthening or reform a bit further beyond this proposal you made. Wolfgang Schäuble has just these days, in accepting the best price in Ireland suggest that this Greece and all the rest should lead even faster to governance reform very much along your lines. And he suggests that you should have the commission president elected by parliaments very soon.

I think that would go a long way in redressing the imbalance that I think, as an integration, rather an intergovernmental list of strengthening the commission. And in fact, enabling proposals like yours, could you elaborate that a bit further? When I think back to the long nights you referred to where we weakened the stability pact and the Euro growth, unfortunately my country was involved.

We could see the weakness of that governance and of the decision making formula that your proposal perhaps with more legitimacy added to the commission, could have avoided.

Jean-Claude Trichet: I feel very, very fully in line of course with what you just said. I had no time to read the speech of Wolfgang Schäuble but I know what he had in mind, so I'm not surprised by what you say. It seems to me that we clearly have to consider the commission as the anticipation of the executive branch. The council as the anticipation of the upper chamber. The parliament already exists, or the lower chamber already exists. And we

already have, I would say, equivalent of the higher court of justice, which is imposing jurisprudence [inaudible 01:27:42].

We see the constellation of institutions which is at state, and it seems to me that this kind of federation—the federation would be full-fledged in certain domains in my option, in the permanent regime. You would certainly have a responsibility at the level of the federation for the financial sector because we have to decouple the financial sector for the various sovereign. It seems to me that it is part of the better functioning of the euro area.

I'm of course mentioning the Euro area in the traditional way as if it was coextensive if I may to the European Union as a whole. I do not forget, of course, that this more complicated than that, so we have permanently to reflect on the interaction between the 17 and the 27, or between the 25 and the 27 taking into account that two countries have an opt-out clause and are in a different legal category.

But elaborating a little bit on the same idea, for those extraordinary decisions that would be taken at the level of the center. If I may, with full backing of the lower chamber, we could even imagine that we could have the voting procedure in the council which would act as the upper chamber, different from the present one, which gives of course a decisive influence to the big countries as is already the case in the parliament.

So it would perhaps be something to reflect upon. But again, I trust that to the extent that it is likely that again, we will not necessarily have an imitation of the United States of America, because Europe is Europe but has a different history. This idea of activating the center only when needed, also goes with the so-called subsidiarity principle which is the heart of the European construction.

But again, we are all learning by doing, and I fully accept that even if in my view, we are not for a proposal of that kind, that—in a new concept, which is not that different from what we have in the present treaty and in a stability and growth pact, because again, you can find a country, the parliament of which has not taken the right decision.

So it goes already very far and you can do that and fine the country without obtaining what you want. Namely that the rest of the Euro area is protected against possible aberrant behavior in one member country. So again, I trust that you have a lot of argument to defend the position. I would love that all countries would reflect upon our long term future, because it's time now.

We have the benefit of the crisis, we see what are the weaknesses, and I have to confess that some countries are more advanced than others in this reflection, meditation, in the long run.

C. Fred Bergsten: Peter Orszag.

Peter Orszag: Thank you, I wanted to return to perhaps traditional monetary policy for a second and your statement that it was effectively equivalent to say, we're in favor of medium to long term price stability and we'll nominal rates low, in the meanwhile, it's effectively equivalent to we're going to keep nominal rates low and by the way we're in favor of medium and long term price stability.

It strikes me that those are actually quite different things because the reason that market participants are always parsing exactly what central bankers say or trying to examine how wide Mr. Greenspan's briefcase is in the morning as a hint is they're trying to guess at what the central bank will do when the world doesn't turn out exactly as expected. And so by emphasizing, by leading with one rather than the other, isn't there actually more difference than you were suggesting.

Jean-Claude Trichet: If you take the concept that we are applying to the letter, you have an enormous difference. Again, we are saying very clearly, our interest rates are designed to deliver price stability in the medium run. We always say in the medium run. And in the medium run, our track record is 2.03% which is a little bit different from less than too close to 2. In the next 10 years, it is more or less what we extract from the market would be 1.9% which would be fully in line with the definition of price stability.

If I understand well, but I'm speaking under the control of eminent Fed representative, in the US, the idea is we will maintain rates at low level for a considerable period of time unless there are reason not to do that, if I understand well. And I think that when you reflect profoundly on that, perhaps you see that it's not that different, obviously.

Because you have this exception clause which is repeated by the Fed chairman. Yes, from time to time, I'm wondering whether the fact that we are plunged in different culture doesn't play a role. It might be different in the US to say, "We will maintain rates, set a low level, [inaudible 01:33:47] but of course, if need be and we were in a different universe, we'll do something different." Perhaps it is accepted in the US culture as much better than to say, "We will in any case deliver price stability, you can trust us, and therefore of course, the medium and long term financial expectations would be fully in line with our definition of price stability."

By the way, there has been an immense convergence between the US and the Euro area because we have exactly the same definition of price stability, I mentioned that en passant. We say, less than 2 but close to 2, and the US Fed says, again, under your control, 2 or slightly below 2.

Again, I don't see, in this case I don't see any semantics difference.

C. Fred Bergsten: Okay, I saw a couple of hands. Dick Cooper.

Dick Cooper: I want to come back to your proposal which I think is both ingenious and far more radical than you let on. You say it's just an evolutionary step from what you already have; it amounts to putting a state in to receivership if you draw an analogy to bankruptcy code. You say you've reached such a state that—and you demonstrated that you cannot manage your affairs on your own, we're going to appoint a receiver and it's worth asking the empirical question, what does that look like around the world?

We have no such provision in the United States. There is no provision for the federal government to put the state—states can put individual cities in receivership, but the federal government cannot do that. I think I'm right in saying that neither Canada nor Australia have any such provision. India does have such a provision. The union can put the individual states. China is not technically a Federal country so they can do anything that the

standing committee decides. Kyle can tell us about Germany, I'm sure whether the federal republic of Germany could put the individual, an individual lot in receivership.

It is, I think a very radical proposal, couched as simply a modest step in central banker fashion, from what we have already, but that's some observations. And my question is: given the way the European public has treated constitutional proposals in the past, what do you think the chances of this particular one proceeding from concept to reality are?

Jean-Claude Trichet: First of all, I fully accept of course that this is something which has not been largely explored. Can I mention that the single currency decided by the number three country in the world, in the advanced economy world, the number four, the [inaudible 01:37:14], the number six, the number seven, and number eight has been experienced either.

So we are experiencing, something which had never been experienced. We are doing that. So it's not an argument to say it's never been done. The quid pro quo is paradoxical there because it is precisely because you do not want, or you consider it's unlikely that you would have the equivalent of the US federation or the equivalent of the German federation and so forth that you have to respect more, if I may, the influence of the states, but at a certain moment exceptionally these states influence, the country influence can be disruptive at the level of the system as a whole.

So you have to choose there: either you consider that it is time to shrink the states and the budget of the various countries and create a very big fiscal position at the level of the federation or you consider that it's better precisely to let them have their own responsibility which are big but to have a way of protecting the system against possible counterproductive behavior.

I fully agree that it is something which is difficult. I have to say that I made that proposal before we had the Greek, the present Greek problem. It's not after the present Greek problem that I made the proposal, but before. I remain very, very strongly of the opinion that not only for fiscal position, but the Greek problem is much more in some respect, the fact that the nominal evolutions, the unit labor cost and a number of cost and price evolution have behaved totally independently of the fact that there is a single currency which has an international cost and an international purchasing power which is defined at the level of the continent as a whole.

So the fact that you would have this tool to prevent part of the Euro area to behave in a disruptive way seems to me necessary. Again, we will see what happens. The main criticism is it is not democratic and that the reason why I consider that the full involvement of the European parliament, which is elected by a universal polling, which has a legitimacy which has the legitimacy of the continent as a whole.

And the fact that the various representatives of the European people would assess the situation, would prevent, I would say technocratic or anti-democratic move in my opinion, at least you would have the real, real checking with the representative of the people. But the simple fact that you are in a single market with a single currency, create a level of interconnectedness that has to be taken into account at seriously, seriously, particularly of course in time of acute crisis.

But in the long run, it has to be seriously taken into account at the level of the institutions themselves, that's my profound, intimate conviction.

C. Fred Bergsten: Ted Truman, and then we'll take a break, have a few drinks, come back for dinner, continue the conversation later. Ted.

Edwin M. Truman: Jean-Claude, it's a pleasure to see you here, after I too have had many years at your side and learning at your knee. I'd like to take you back sort of where you started your remarks and because you linked together where were from the August of 1907 to today, and ask you to comment a bit on the question of sort of—we've had two epicenters in your terminology, we had one epicenter here, right at the beginning and now we have an epicenter in Europe.

There is a view, and I'm asking you as knowledgeable European; there is a view that the second epicenter was essentially caused by the first epicenter. And we, the United States has just run our business right, all manner of business whether it's regulation or macro fiscal policy or monetary policy, right? Then none of this would have happened in Europe.

And so therefore, the Europeans can blame the Americans for the last two years as well. So that a common view, I think as I hear, from some Europeans, maybe I'm—speak to the wrong people, so I'd be interested, given the nature of this audience, which is mixed for your views on that sort of how these two pieces of the crisis have played off each other.

Jean-Claude Trichet: Well, first of all, I have to say that the fact that you have the sad privilege to be at epicenter of the crisis, which was the case of the US for the first episode, subprime, I would say mid-'07 up to mid-September '08. And then mid-September '08 up to end of '09. And then we had the third episode where the epicenter crossed the Atlantic because we were the realm of the sovereign risk crisis.

I would say, those in Europe who were saying that it was not a European problem at all, that it was the US problem in the first and second episode, we are plain wrong, of course. It was the US problem and it was our own problem. As I said, on both sides of the Atlantic, you had to put 27% of the GDP on the table, to arrest the tsunami.

And so it's true that the epicenter was in the US; it's also true that we are so intertwined, so interconnected that we were fully, unfortunately participating in the fragility of the world. I would say, equally, those who are saying in Europe, "It's not our problem, it's because of the US," are wrong in my opinion.

Because the—it's true that if the crisis had not been there, we would not have this scanning, this x-ray of our situation. But the situation was not appropriate at all. In a way, it took chance for the European to see that they have to put their house in order to make a quantum leap in terms of governance, economic governance.

On the other hand, it would be equally misleading in my opinion for the other advanced economy to think it's only a European problem. It was plain wrong from the European to say it's only a US problem, it would also be plain wrong to say this sovereign risk issue is only a European problem. In my opinion, it's a crisis; it's a crisis

which is hitting all the advanced economy and there is somewhere, very unfortunately, in the Euro area, an epicenter.

But house have to be put in order everywhere in the world. Because there is no more privilege, which is given ex ante to any particular signature. The signature have to prove—I have a last point if you permit, Fred.

When I look at the advanced economy, who—which advanced economy proved incredible resilience in the crisis? Sweden, Canada, Germany. Why? Sweden had a dramatic crisis at the beginning of the '90s, they put their house in order. And a house in order meant 12% or 13% diminishing of public spending as a proportion of GDP, I mean it was very, very strong. And in Scandinavia in general but in Sweden particularly.

Canada. It's very surprising; Canada is resilient, it's very close to the US, interconnection is very horrible. Canada was in a dramatic situation at the end of the '80s, put their house in order, took a lot of time, but proved an incredible resilience. And Germany had the reunification, and immense increase of costs in Germany, which was normal after reunification, then of course hard work being done, practically during all the time of the Euro with unit labor cost being moderated, moderated, moderated.

And very tough decisions taken. 3% increase of the VAT with the full agreement of the left and the right, and finally resilience in the crisis which is so obvious. But the three countries did the job before. And we are protected from drama in the present episode of the crisis because they had done the job before.

Protected not entirely of course, particularly in the financial crisis, in the first episodes.

C. Fred Bergsten: Jean-Claude, we have deeply appreciated your wisdom. Jean-Claude, thank you, [and] thanks again to the Niarchos Foundation.

