

Tommaso Padoa-Schioppa on the Financial Crisis

Interview with Stefano Lepri

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Q. Wall Street investment banks go broke or struggle to survive; Communist China has enough dollars in its coffers to buy them all. To what kind of world globalization is leading us to?

A. «**Globalization is in fact at a crucial juncture, made more difficult by too long delays in adopting corrective actions. Today's difficulties arise from three sources: financial instability, dearth of savings in the US, rise of Asia both as a low cost producer and a voracious consumer of fuel and food. The financial turmoil is only a part of the larger picture**».

Q. Some years ago, globalization critics were pointing to the danger of a thoroughly Americanized world. On the contrary, the US is losing weight in the global economy.

A. «**In the next few years, I believe, US contribution to global growth shall become scant. If a country needs to save more – it's quite obvious – its growth slows**».

Q. After 1991, in a unipolar world, US power appeared bound to no limits. Wall Street investment bankers, too, were confident to them everything was allowed?

A. «**Business people aren't always able to keep their heads cold when their business is in full flourish. It would be sad, though, if the current turmoil turned to arrogance all those who didn't make big mistakes up to this point**».

Q. But who let them revel? Were the regulators sleeping? You are a former central banker...

A. «**Central banks have fought long, and righteous, battles to gain independence from political power. But they may have become too dependent on markets. Since a number of years I had been worrying about this issue. I remember touching on this subject in my farewell speech at the Bank of International Settlements in 2005**».

Q. I guess you find fault with the Fed, not the Ecb.

A. «**An overflow of liquidity lowered all financial yields. When everybody is looking for higher yields, riskier investments become unreasonably overpriced. Each investor thinks to be smart enough to sell before the tide changes; but only a few manage to escape, and most of the herd falls into the ravine. Interest rates stayed too low for too long; both because of complacency towards the market exuberance of the 1990s, and for desire to prolong high growth rates in spite of the lack of savings and the accumulation of the external debt. So we experienced a sequence of speculative bubbles: emerging markets, high-tech, housing**».

Q. With a diminishing role for the US dollar, will the financial system become more unstable?

A. «**Yes. Unluckily yes, and I don't have a solution in sight. Financial turmoil, US external debt, ascent of the euro, concur in revealing the internal weakness of a system where one nation's currency is the global standard of value. All the great economists, from Hayek to Keynes in our past to Robert Mundell nowadays, deemed a single international standard of value was needed. Without it, how can we fight inflation when it comes, as it does now, from commodities and not from wages?**».

Q. Coming back to the first question: How is our world changing?

A. **«Emerging powers, like China, India and Brazil, must be offered a larger role in the multilateral fora: Imf, Wto, World Bank, G-7. A century ago, when new powers came around, no way was found to accommodate them into the existing framework; so in 1914 the breakdown of the old order led to war. I see little reason for optimism when I see some countries from Europe sticking to their share and to their seats, and others still clinging to the delusion of a world order based on one country's hegemony».**

Q. In 1914 too, on today's standards, economic globalization had gone a long way.

A. **«Yes, and almost a century had to elapse before we got back to the same point. Conflicts in Europe were solved by the intervention of an external power, the US. Nowadays the entire world takes part in the game, and there isn't any external player to which we can turn for help».**

Q. Until a couple of years ago, Alan Greenspan was praised because he had first detected a new phase. The Fed could keep its rates lower, because productivity was rapidly rising. Is Greenspan the main culprit?

A. **«I don't like to personalize issues. The trouble has been that the usual alarm bell – I mean, inflation – didn't ring. Economic theory taught us that when too much money is around, inflation soon rises. But China helped us to keep inflation low, by flooding us with cheap goods».**

Q. Still in these days markets ask for more of the same. Addicted to low interest rates, they press central banks to slash them.

A. **«Well, it's like with drugs. In certain occasions, junkies are best cured with drugs, with – what is it called? – Methadone. It may well be that, in the short run, a small amount of drug is necessary. But only in the medium term we'll see what lessons the Federal Reserve has taken from the current events. My hope is this turmoil opens everybody's eyes: It's dangerous to be too complacent towards the market. "If it isn't broken, don't fix it" the Americans say; but there aversion to preventive cures has been pushed beyond the limits of prudence».**