

Interview with Jacques de Larosière

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Marcin Piątkowski: Good afternoon, Mr. de Larosière. You have come to visit the Leon Koźmiński Academy of Entrepreneurship and Management in Warsaw. Is this the first time you are visiting Poland?

Jacques de Larosière: No, I have been to Poland several times. I first became associated with this country when I was at the IMF, and then afterwards at the Banque de France, and finally, even more so, when I was the President of the European Bank for Reconstruction and Development (EBRD). So, I have come here many, many times.

Marcin Piątkowski: Within the context of the EBRD, how do you see the evolution of its role in terms of its mission in transition economies?

Jacques de Larosière: I think that the EBRD has to always be at the cutting edge of innovation. The EBRD is not supposed to substitute the financing that can be done normally by banks, private markets, etc. It is there to make projects happen that would not have been possible if one had to rely only on private sources. The role of the EBRD in a country like Poland, which has advanced a great deal towards integration into the world economy, is of course changing. It has to focus on the types of projects (for instance small enterprises, or municipalities or anti-pollution concerns) that in themselves are more difficult to finance normally, that is using private financial channels. Here the EBRD is very important. First of all, because its mission is to promote transition. The EBRD has to find (and it is doing it, I think, very successfully) a combination of projects where, of course, they lend in a normal banking way, that is to good projects that have an acceptable return, but without just doing the same things as the private sector. Second of all, the EBRD has to be in a way always at the cutting edge of the frontier of innovation. Thirdly, it has to contribute to the success of the transition process. All these factors are, I think, taken into consideration by the EBRD.

Marcin Piątkowski: It seems that the EBRD is receiving a much better assessment as compared to the IMF, which is, as we have discussed during your lecture, quite widely criticized. How do you see the changing role of the IMF?

Jacques de Larosière: The IMF can be seen a little bit like the doctor that has to prescribe to its patients sometimes painful remedies, whilst the EBRD is the good guy because it brings money and helps create important projects. It is inevitable that in terms of getting marks, in terms of popularity, the doctor is always a little less appreciated than the good guy who brings you new ideas and new projects. I think that the role of the IMF has really never changed. They have to insist, and help countries to adjust their imbalances, be they fiscal or structural. The role of the IMF is not just to provide money: it is to provide adjustment and advice. Of course, the adjustment has to be decided by the political authorities in the country, but still the IMF can help through its advice and its conditionality to promote more efficient management of rare resources. I think, and I have said it today in my speech, that there have been a lot of different catchwords in the IMF meetings over the last 30 years but the leitmotiv that is running constantly through these meetings is the need for adjustment. We all know that.

Marcin Piątkowski: Some people are arguing that there should be a sort of a global government controlling financial flows, since these are often regarded to be the main culprit of the recent Asian and Russian financial crisis. Would you see a chance for the IMF or any other international organization to set up a sort of a global supervising body?

Jacques de Larosière: I am not sure about the way it could be done but I think that if we refer to the South-East Asian crisis, it is not so much the liberalization that has been the source of the problem. It is the liberalization combined with the absence of, or the insufficient existence of the local supervisory force in the country. Look at the enormous increase in the external indebtedness of the private sector in those countries over the last years before the 1997 crisis. There has been a huge mismatch between assets and liabilities in their firms and banks. In other words, they have borrowed very significant amounts of money in dollar terms where the interest rates were lower than the domestic interest rates, and they invested that in housing and manufacturing projects, which, I must say, were not all well chosen. Of course, when the crisis came and the confidence of the external markets petered out, and the currency depreciated, then those companies were faced with very large cuts as they had to pay much

more local currency to reimburse their foreign creditors than they had thought they would. Many of them therefore fell into bankruptcy and the whole system collapsed. Is that the effect of liberalization? You can say yes, but you can also say that it is the effect of liberalization not buttressed by local supervision. Should the supervision (for instance, preventing domestic banks to have open positions in foreign exchange without any regard to their capacity to repay), be then transferred to an international organization? I do not think so. I think countries like Chile have shown that it is possible to have national regulations that will limit the short-term external indebtedness of banks and of companies. Should we have a vast bureaucracy in the world for such countries? I am not sure. I think nations should be able to control their systems. But the general framework should be assisted by IFIs like the IMF.

Marcin Piątkowski: Talking about post-socialist countries, there is an ongoing debate on the virtues of unilateral euroization. Professor Grzegorz W. Kołodko in his recent publication was arguing for the devaluation of the Polish złoty followed by the adoption of a currency board system of a fixed exchange rate. What would be your opinion on the virtues of the unilateral euroization in the post-socialist candidate countries to the EU?

Jacques de Larosière: I think that before answering that question, one really has to address the basic subject. The basic subject is that Poland is one day going to get into the European Monetary Union. It is not a question of 'if'; it is a question of 'when' and 'how', because, as you know, you have no optional clauses like Denmark or the United Kingdom. So you are going to enter. Instead of saying: 'We have to do this, and that, and so on', I think you have to have a broader view, which is: What are the best conditions for Poland to access one day the European Union and the Monetary Union?

I would say that two things are obvious. One is mastering inflation. This is very important if you want to join a group of countries that have very low inflation rates (the European Central Bank has a target of 2 percent annual inflation as a maximum). If you really want to participate in that kind of zone, you have to be sure that in Poland inflationary expectations and the actual inflation is going to be no more than 2 percent. You are making very big progress in that direction because inflation now in Poland is reducing, but you should nonetheless continue a policy that leads to the entrenchment of these low inflation expectations. That is the first thing. Before saying that you have to change the exchange rate,

(with its inflationary impact), I would be very careful not to disturb the steady, constant lowering of inflation expectations because that is a must.

The second thing you have to do is to make sure that the labor market and markets in general, are flexible enough to cope with the fact that they will no more have the flexibility of the exchange rate. Before you lock yourself into a system where you have no more influence on exchange rate, which will happen if you are in the monetary union, you have to have some flexibility in your markets and in particular in your labor market, because if you loose competitiveness because of the pegging to a relatively highly-valued currency, then of course you need to be flexible on the wage side if you want to keep your competitiveness.

The third thing is that you have to put the fiscal position right. I think it is more important to put the fiscal position right than to make dissertations on what is the appropriate level of the zloty. I think the level of the zloty would be much more appropriate if you would have Maastricht conditions met, that is anti-inflationary expectations firmly established, a reform of the efficiency of the markets designed to increase their flexibility, and thirdly a more efficient and less deficit-oriented public sector. If you have those three things, then you will be at the door of the European Monetary Union and you will be able to enter it. The quicker it is done, the better, because pre-accession periods can be very disturbed by capital movements. I would hesitate very much to use the exchange rate as a tool of short-term economic stimulation of the economy. This is not the way I would look at it.

Marcin Piątkowski: Taking into account the well-established Balassa-Samuelson effect that will for long render inflation in transition countries much higher than in the European Union, would you be a supporter of the devaluation of local currencies before they fix to the euro or would you rather just fix it at the then prevailing market rate?

Jacques de Larosière: I think you really have to have a view of the competitiveness of an economy. The Balassa-Samuelson effect is indeed a factor. First of all, it is not only, if I may say so, limited to accession countries. We have that effect in France; every country has the Balassa-Samuelson effect, because they all have a non-traded goods system and services system that may be contaminated by the more dynamic wages of the traded goods sector. It has been a big disadvantage for transition countries for some time, but now that you have a relatively large part of your economy that is trade-related, I do not think the Balassa-

Samuelson incidence is much bigger than it is in our own, more developed countries. Maybe it is slightly bigger but I have read an econometric work that shows that perhaps that effect is responsible for one percentage point to your inflation, but it is, nevertheless, on the declining side. It is maybe adding 0,7 percentage points in our more developed systems, so the differential is pretty low. I would not, however, put too much emphasis on that.

Marcin Piątkowski: Now, delving into the issue of the European enlargement, how optimistic are you about the chances of the Central European countries joining the EU in a little bit more than a year from now, that is in year 2004, whilst facing the seemingly rising wave of xenophobia and nationalism in Europe? Do you think that the EU countries could have a problem with ratifying the enlargement treaties?

Jacques de Larosière: I do not believe that this would be a problem because the anti-enlargement fractions in our countries are relatively limited. I very much hope that if a referendum was held, not now, but at the time when the conditions for your countries are met, there would be a majority for the enlargement. The enlargement is a politically supported idea. It is also politically complicated but it very much will depend on the quality of pre-convergence results – the more you converge, the less opposition there will be. Secondly, much will depend on the political will of our own governments because they have an influence on the public's attitude towards enlargement. My impression is that they want to do it. The more difficult challenge is that our governments in the existing European Union have to change many things in their own economies, in their own agriculture policies, in the functioning of the institutional setting of the European Union, if they want to have a smooth entrance of the candidate countries. In a way it is true that you have difficult political and economic structural reforms to do, but it is also true that we, the EU, have difficult political and economic structural reforms to do, too. In a way the challenge is double. I am not so sure that the most difficult set of problems is not in our countries.

Marcin Piątkowski: I was wondering what are the reasons for the current situation, where there is hardly any economist hailing from the post-socialist countries, who would be at the head of any significant economic international organization like the IMF or the EBRD. The question then is what does it take to become a head of either the IMF or the EBRD or the World Bank?

Jacques de Larosière: I hope you have to be competent, you have to be able to lead, to be independent, to be really independent.

Marcin Piątkowski: Do you believe that in the future there will be a chance for someone from a post-socialist country to assume the leadership of the IMF?

Jacques de Larosière: If that person is good, if that person is a leader, if that person has also experience, an experience that shows that he or she can live up to his or her promises, objectives – then why not?

Marcin Piątkowski: My last question: Do you think that France will qualify to the second round of the World Cup?

Jacques de Larosière: I have not really seen the conditions for them to qualify. I think they have to beat Denmark and Senegal has to lose to Uruguay – those are two conditions. I have no personal idea of that matter. But I think it would be a great amount of luck if we did.

Marcin Piątkowski: Thank you very much Mr. de Larosière.