Governor Trichet thanked Professor Mishkin for providing the symposium with a fertile ground for discussion, as the time had come to bring it to an end. He pledged not to make long commentaries, contenting himself with observing that the lecture had given valuable insights into a long-standing debate regarding the way the US and European monetary policies should be construed. He noted that differences in legislation might have given the French public the delusive impression that the Federal Reserve and the ECB had different concepts, with the former pursuing two conflicting objectives —namely price stability and growth — while the latter would have only focused on the first. He stressed that Professor Mishkin's presentation stood in stark contrast to this view and asked him whether, in his opinion, Europe and the US were actually different in what they do. He then seconded Professor Mishkin's remark about the pragmatism of central bankers working wonders, as long as they stuck to price stability. His impression was that the finest understanding of the transmission mechanisms of monetary policy would always pose a serious challenge to central banks, even when concepts and regulations kept being refined by the academic profession. Finally, he agreed that the appropriate mechanism for dealing with the erosion of demand for the monetary base was to set up a "channel" system, as exemplified by the standing facilities in use at the ECB, and asked whether, in the long run, there would not be a potential problem with the Federal Reserve in this respect. He then took questions from the floor, encouraging participants to be as "bold" as possible.

One first comment was that innovations could in fact mitigate financial risks by separating the payments system from the credit system. In that sense the problem could be less dramatic than sketched in the lecture. In addition, many central banks, at least in Europe, appeared to be doing both the supervision and the competition, and perhaps these functions should be separated out. So maybe this was bold enough to start off. A second question was raised about which kind of institutions LCBOs were comprised of. Many European banks could in fact be American institutions operating out of European capitals. Moreover, they could include large insurance companies with a different supervisor and a different regime. This could have implications for supervision. A further comment called into question the "circling the wagons" solution to the too-big-to-fail problem because of the risk of strategic manipulation. The danger seen with the suggestion was that a bank engaging in risk-taking activities could hold another bank hostage, driving it into a crisis before revealing its own problems. To this extent, the solution would create another strategic problem by actually inviting risk-taking.

In response to Governor Trichet's comments, Professor Mishkin stated that the US and Europe did not have a different interpretation of monetary policy. Legislation in the US was a vestige of a different kind of thinking, with the Humphrey Hawk Act basically saying that the Federal Reserve System was supposed to do anything, including making sure that "there was a chicken in every pot." Clearly, the Federal Reserve had a large degree of latitude when it came to its interpretation. Alan Greenspan, other members of the Fed and even the executive branch now agreed with the ECB that price stability was the key long-run goal which itself led to economic growth. The difference was rather that the nominal anchor in the

US was based on one individual rather than on an institutional framework, while in Europe price stability was part of the charter of the ECB. In short, there would be no difference for all practical purposes, although the situation might change in the future. He also acknowledged that the US had a different system of setting interbank interest rates and, as a result, might be more affected than other countries by the shrinking of the demand for reserves. His prediction was that the discount window, which allowed lending at sub-market rates at the discretion of the Fed, would eventually be replaced by a Lombard-type facility of sorts.

Professor Mishkin then moved on to the issue of risk-taking activities by banks, and reckoned the technology to be a crucial factor in the well-functioning of payment systems. Real time gross settlement systems, like the TARGET system, reduced the amount of credit risk embedded in transactions. The more one could ensure that there was no credit aspect to the transaction, the easier it would be to unravel the failure of an institution. He related this to a question about strategic manipulation in a world with interbank credits, where the withdrawal of a credit line by one large bank would possibly mean that a smaller one was actually going under. If the large bank were running up the risks and knew it were going to be at least number two, and possibly number one, it would “pull the plug” and let the small bank fail in its place in the hope of partaking in the safety net. In order to prevent such strategic schemes from occurring, the key issue was to make it easier to unravel any institution that got into trouble by retracing its transactions through the payments system.

Professor Mishkin doubted that any kind of restrictions imposed on bank activities could be instrumental in solving the challenges posed by LCBOs. Governments, for example, would not think of dispersing large city dwellers to the countryside under the threat of terrorist actions. Similarly, they should not get involved in curtailing bank size or activities, as efficiency losses might well outweigh safety gains. The important point was that governments should avoid providing large subsidies. This seemed to vindicate the proposal put forward in the lecture of actually making the first bank get hit, while circumventing damages to the rest of the system, even if this did not entirely solve the moral hazard problem. He noted incidentally that the issue of LCBOs was an instance where the free-rider problem was actually working in the right direction. An institution might think that if it got larger it would earn its way out of trouble, but this required coordination of all creditors. So letting the free-rider problem play its role could actually help the market discipline large institutions.

Finally, Professor Mishkin pointed out that one of the big challenges going forward would be to think about how to supervise large institutions. Even if it were desirable to have separate supervisors, some agency would remain in charge of the consolidating. This was one of the reasons why, no matter what people said, central banks should remain an important element of the supervisory process. This could be even more relevant in the context of Europe, where different supervisory agencies coexisted in different countries and yet only one central bank stood as the backstop of the system. Working out the supervision against this backdrop should be a major challenge for the ECB.

Governor Trichet elaborated on the Eurosystem's current reflections about the failure of large banking institutions. The decision whether or not to assist a problem bank should be made by the relevant NCB but, at the same time, the evidence would come under close scrutiny of the full body of the System. For small scale operations, the Board could let the NCB get involved with the problem bank, which would imply that the national government would feel the full brunt of the losses, if there were any. On the other hand, if the assessment of the executive Board were that the risks were simply too large to be borne by the NCB, the Board could use a particular provision of the Treaty which would give them the right to say no even if the NCB was willing to assist the bank at its own risks. One might even imagine a bizarre situation where the Board would allow for some kind of open assistance while the NCB would prefer not to intervene, but this reverse situation would seem very uncanny. The odds were that the Board would call for a majority of two thirds to exert a veto right against the dissenting NCB, lest this would create large disruptions at the level of the Euro zone. This would be the implicit solution "enshrined" in the concept of the Eurosystem.

One question was then raised about the relative importance of transparency and inflation targeting in the strategies of both the Fed and the ECB. Professor Mishkin replied that the ECB had advantages in some ways but not in others. The positive aspect was that the ECB framework was very close to inflation targeting and actually quite explicit. By comparison, the US did not have an explicit inflation goal, which at this juncture Alan Greenspan was opposed to given his personal credibility. He saw nevertheless a problem in terms of the communication strategy of the ECB, especially at a time when its actions would otherwise appear to be fully consistent. His explanation was in part that the information contained in monetary aggregates, although quite valuable, could be misleading. The reason why the first pillar had been put into place was in his opinion political, as the ECB would have desired to be the "baby Bundesbank." Monetary targeting had indeed been successful in Germany, but could work less well for the rest of Europe, because it was not deeply ingrained in some of its cultures. In addition, the ECB was a brand new institution which had had to learn how to communicate quickly. In sum, the ECB could be at a relative disadvantage to the US in terms of communication, but ahead of it in terms of the basic institutional infrastructure. Over time, things could get better for the ECB and, hopefully, not too much worse for the US.

In response to this criticism, Governor Trichet offered his own reading of what had been occurring in Europe. The mainstream analysis in the US had tended to conjure up a vision of monetary union in which the Euro was merely a basket currency, and the single yield curve a weighted average on which interest rates in participating countries would have progressively converged. Instead, and through much hard work, central banks had succeeded in crystallizing the market thoughts on quite a different arrangement that had all constituting currencies benchmarked on the strong soil of monetary credibility and confidence. The yield curve which the entire Euro zone was now reaping the benefits of had inherited this credibility not because the ECB had been the "baby Bundesbank," but because it had embodied the best behavior of all former currencies. In other words, it was the very requirement that the yield curve epitomize the best legacies in Europe that had held the mainstream analysis in check and had prevented risk premiums from developing. The French central bank had in her own legacy a history of five years of independence, the monitoring of M3 besides a series of other indicators, and a less than two percent explicit target, to name just a few. With regard to communication he recognized that, quite naturally, the ECB strategy was intertwined with the ten languages and twelve cultures which composed the monetary union. He noted however that, with the immediate delivery of its joint analysis, the full body of the college was able to provide clear terms of reference, which were agreed upon and easily translated in each country. Unlike the US, the ECB was also keen on making public its diagnosis without delay, in order to reduce any misunderstanding with, or idle gossip from, the financial press.

In conclusion, Professor Mishkin acknowledged that the ECB had been very successful in making the people understand that price stability was a long-term goal and that, over time, its situation would probably be better than that in the US. But thinking and actually dealing with suggestions that might make the communication simpler, and which the ECB had often been quite responsive to, would only help the public from various countries in Europe understand more effectively its strategy for exactly the reasons Governor Trichet had just given.