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I am not sure I like that introduction, but I will try to be, at least, enlightening on some dimensions. What I want to do, actually, is step back a bit. I have enjoyed both previous presentations, but I want to raise some questions that are of a more general nature, about some of the systemic issues associated with the international financial system. I think that we face a basic contradiction in thinking about contemporary international finance. On the one hand, a consensus has developed over the last 20 years, which I think is accurate, in support of an integrated international financial system, a belief that capital should flow from regions that do not have as much need for it to regions that have more need for it. This is the way international capital markets should work, and I think there is a very broad sense that this is justifiable. That is on the one hand. On the other hand, I think there is a more or less equally strong consensus that the basic roots of the crisis we are still living through can be found, in very large part, in the global macroeconomic imbalances that developed over the previous decade. But “global macroeconomic imbalances” is just another name for international capital flows. So, on the one hand, we have a view that international capital movements are overwhelmingly positive and play an extraordinary important role in a modern integrated international economy. Yet on the other hand, we have the experience of the last decade, in which these international capital flows seem to have been at the root of the most serious crisis since the Great Depression. And I agree with Monsieur Trichet that had it not been for the aggressive action of monetary and other policy makers, it might have been greater than the Great Depression.

How do we understand this contradiction and what might be done about it? First, let me start with the experience of the past decades and what it is about the contemporary international financial scene that gives us some cause for pause and, perhaps, even for concern. There are potentially troubling aspects of international financial flows that do raise questions about how positive they may have been, and suggest that they may be creating potential problems on several dimensions. There are three dimensions that I think have been important I might note that my observations complement Josef Ackermann’s points about the banking system, because many of the issues that he raised are, in a sense, the mirror image of broad systemic international developments, as seen through the banking system.

The first dimension of concern is the existence and persistence of capital flows that seem to contravene usual and desirable patterns of expected capital movements, that is, from rich countries to poor countries. We have become very used to capital flowing from rich countries to other rich countries, for reasons that we understand, having to do with different demographic profiles, risk profiles, and characteristics of financial systems. Over the past 15 years, however, we have seen enormous capital flows from poor countries to rich countries, for reasons that do not seem to have clear economic justification. To put it somewhat differently, capital is flowing from poor countries to rich countries for reasons that do not seem consistent with the economic rationale for investment flows. Instead they seem to reflect government-driven goals, which cannot really be regarded as reasonable. Such arguments for them as insurance motives for holding extraordinarily large reserves, fall flat. These government policy-driven capital flows for which the rationalization seems questionable has received a fair amount of attention.

Second, there are capital flows that appear to impose costs on individual financial partners. This was much discussed during the run-up to the crisis, between 2003 and 2007, when there was much discussion of the potential dangers associated with the global macroeconomic imbalances. It was observed that one country’s policy-driven capital movements could impose externalities on other countries. For example, we can observe, without imposing or suggesting any moral judgment, that one country’s large-scale surplus implies large-scale deficits on the part of other countries. No one can force you to borrow, of course, but the existence of large-scale surpluses almost certainly distorted the incentives to other countries. At least some of what happened over the previous decade was that large-scale surpluses made capital available to countries that had strong incentives to use these funds for purposes that turned out not to be productive. This, of course, is something that we would like to try to avoid. So there are country-to-country externalities that we can think of being imposed by these types of macroeconomic imbalances, which can distort incentives, both to countries and to households, individuals, and to the private sector within countries.

Some of these externalities, by the way, may be political. In the recent period, we see that the existence of these macroeconomic imbalances can create political problems for national governments. Without naming names, it is clear that when national governments run large-scale surpluses for the purposes of holding reserves to keep their currencies artificially weak, this can fan the flame of domestic protectionist pressures in their trading partners. The externalities may be economic, in the sense of distorting incentives to deficit countries, and may be political, in the sense of creating political tensions among countries that are experiencing some of these imbalances. This second dimension of problematic developments in the international financial markets deserves attention.

The third dimension is the one that Monsieur Trichet has mentioned, the creation of costs to the international financial and economic system more generally, that is, not so much externalities imposed by individual countries on other individual countries, but externalities imposed on the international financial system as a whole. There is by now, at least among academics, a general consensus that whatever one may think about the economic and systemic effect of net capital flows, the size of gross flows has created real problems for regulators, for financial institutions, and for the international financial system more generally. The extraordinary proliferation of extremely complex instruments, the great lack of transparency in those instruments, the development of structured finance and the shadow banking system, the size of gross flows in the international financial system, and the speed of transactions – all this means that contemporary international finance very rapidly and efficiently exposes just about any possible weakness in the financial infrastructure. Banks and countries that are too big to fail create almost immediate moral hazards, to which the system responds. This response, whether it involves capital flows or investment decisions, like the portfolio decisions that were mentioned earlier, can create systemic problems. There is the related potential, realised in 2008, for extraordinarily rapid and extremely damaging contagion, as financial markets are much more tightly tied together. There is also the continuing possibility of very high levels of regulatory arbitrage, where we do not, of course, have a harmonised international financial regulatory architecture. The size and scope of gross flows means that regulatory arbitrage can be extraordinarily easy for financial institutions to engage in.

These are some of the systemic externalities that international financial integration seems to have created. This is not, I think, particularly controversial, in the sense that most scholars who have looked at this have identified these issues as of grave importance moving forward, in trying to think about an international financial infrastructure that serves the purpose that international finance is supposed to serve, which is to move capital from places from where it is less needed to places where it is more needed, without risking the very stability of the international, financial, and economic order.

The question that one might ask, for a more policy-orientated standpoint, is what might be done to realise the positive effects of international financial integration, while mitigating some of its more negative effects. Here, I will certainly endorse what Mr Trichet said, which is that in the recent past central bank cooperation has been extraordinarily effective, indeed central to limiting the effects of the crisis that began in 2007. However, I would take a further step and say that that is not enough. Monetary policy and international monetary cooperation is not sufficient to avoid a continuation or a recurrence of the kinds of difficulties that we experienced. Monetary policy is one important leg of national economic policy, but we cannot run national economic policies and international economic policy cooperation solely on the basis of monetary policy cooperation. It has been very difficult to move further, whether on fiscal policy, regulatory policy, trade policy, or other policies, in a more cooperative way. There has been a great deal of attention paid to thinking about these systemic issues, to harmonising and standardising financial regulation across borders; however, I am sceptical of the ability of movement in that direction to have the desired systemic effects. I am sceptical for a couple of reasons. First, as we have seen, it has been extraordinarily difficult to achieve any meaningful harmonisation of financial regulations among countries. The fact is that national financial systems are extremely different on many dimensions. Long histories of financial regulations are at stake, and the preferences of the major financial centres with respect to financial regulation diverge immensely. The willingness and ability of the major regulators to work out a common cooperative approach is very questionable. I think that, whether from a theoretical standpoint or from a pragmatic standpoint, the likelihood of some meaningful harmonisation of financial regulation among the major financial centres is not likely to be the answer to our prayers with respect to stabilising international finance. It is desirable, but I do not think that it is the most promising direction to go in.

What, then, would I suggest? I would suggest that the core of the problem is macroeconomic policies and, in particular, macroeconomic policies directly related to the capital flows that we have seen over the last decade. There is a long

history of scepticism, which I have shared, over both the desirability and the possibility of international macroeconomic policy coordination. This scepticism is due largely to the theoretical approach that was prominent, and almost universally accepted for 25 or 30 years, which was that macroeconomic policies adopted by an individual country were primarily imposing costs and realising benefits for itself. I think, over the past 10 years, we have come to soften the view, for – to reiterate – it is clear that global capital flows can create both cross-national and systemic costs for partners and for the international financial system more broadly.

If there are externalities, as I think there are, then there is scope for cooperation. Since about 2003, some of the international financial institutions, like the IMF and the BIS, have focused on the desirability of more direct policy attention being paid to global macroeconomic imbalances. They did not get much of a hearing. Their attempts had very little impact on actual national policy, but, despite the fact that success was limited in the run-up to the crisis, the issue was at least put on the agenda. In an environment in which there is limited political capital and limited scope for cooperation on many dimensions, we must choose our weapons, and choose our battles. My view is that working towards a global regime for international financial regulation is choosing the wrong battle. I think it is very unlikely that we will achieve meaningful, global harmonisation of financial markets or harmonisation of financial regulation, given the great differences among our financial markets. I do think that any scope for meaningful cooperation involves trying to work out some serious attempt at coordinating macroeconomic policies among the major economic powers. This is what creates the incentives, perverse or otherwise, for the financial behaviour that Mr Ackermann has so accurately depicted. As such, in my view, the principal lesson of the past decade is that international financial flows, while desirable, can create serious problems, both for individual countries and for the international financial and economic order more generally. We want to sustain financial openness, but we want to avoid another collapse. And I believe that the best and, perhaps the only feasible, way to do so is to undertake systematic attempts to achieve a meaningful coordination of macroeconomic policies among the major economic centres.