DEBAT

Karsten Langer, Dirigeant associé, The Riverside Company, et Président de l'EVCA

I am the outgoing chairman of the European Private Equity and Venture Capital Association (EVCA), a European trade association and in that role I sit very much at the crossroads of the financial sector and what we have come to call the real economy as we raise our money in the financial world and deploy it in real companies. I would like to come back to two topics on financial regulation that were mentioned at the beginning. One of the topics is where I think that we have not gone far enough and the other is where I think that we are at risk of having gone or going too far. Let me take a populist approach here. If you asked the question 'Did the right people pay for the crisis?' and put that to the 10 million people who have lost their jobs in Europe – and I speak mainly from a European perspective – they would say 'No. The right people did not pay.'

We heard about the 27% of public sector guarantees but what we have not seen – and perhaps it is time to do it now that we have a little bit more stability – is more real raising of equity by the European financial sector – in other words, forcing the banks to go to the market and raise real equity capital. This would eliminate the problem of the legacy assets because no investor would put in money if they did not believe in the balance sheet. If it was possible to do this, I think that we could accelerate the re-establishment of a banking sector that had the confidence of the market and consumers. We were bold with the sovereigns and it is now time to be bold with the banks and the private sector, in that sense.

The second area where I think that we are at risk of going too far is the question of how we safeguard long-term investment. Given the nature of the Lehman crisis and the liquidity trap and so on, we have come to say that the answer is to force everyone to hold more liquid shorter-term assets. In fact, what we are not doing is encouraging investment in asset classes that drive long-term growth in the economy, be they infrastructure or building companies or whatever it might be. We are even now talking about applying these same rules to investors that have long-term liabilities, such as pension funds and others, where it is really nonsense to force them to hold short-term assets. I think that we are actually at risk of going too far here and prolonging the crisis in Europe.

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

Thank you very much for your point and for being so concise. On your second point, I think that it is a major issue, to the extent, for instance, that the G30, which I chair, is concentrating on this long-term investment issue as we have the feeling that there is simply something wrong with the present tendency and global trend, as you mentioned very wisely.

On your first point, I think that, very fortunately, a lot of wealthy people lost a lot of money in the crisis. If you look at the stocks and shares of the financial institutions, you can see that a lot of people lost a lot of money. In terms of communication, you can understand that it is hard to cry for them and their loss of capital, but it has obviously been large and the number of changes in the top management of banks that were not properly managed has also been enormous. Fortunately, it is a little more balanced.

I also mentioned the 27%, but the 27% of taxpayer risk has not been utilised in most countries. It was therefore a risk, but fortunately it did not turn out to be a subsidy or anything of a similar nature, apart from in very special cases. Fortunately, therefore, it is a little more balanced. Nevertheless, you make a very important point. It is unforgiveable to have allowed the global economy – at least the advanced economy – to get to a point where such a harsh adjustment had to be made for their own people, without people realising that it was not a stable situation.

Joseph Ackermann, Président du conseil d'administration, Zurich Insurance Group Ltd ; ancien PDG, Deutsche Bank

Regarding the question why banks have not raised more equity in financial markets instead of taking public money? The answer is very simple: the valuation level was and still is so low that if you do that, you dilute your shareholders or if you do it with subscription rights then you are using a lot of your authorised capital and there is not a lot of initial capital increase. Capital ratios, though, have been increased dramatically. European banks are at 9 percent core Tier 1 and most will be at 10 percent under Basel III, which will be phased in a relatively short period of time. Confidence is coming back from both a funding and credit default swap (CDS) spread perspective. This is being achieved less through the raising of equity than through deleveraging, which is not a bad thing, in fact. Deleveraging has not really affected the loan portfolios, but the trading assets and I think that reducing risk-rated assets and cleaning up the balance sheet is the right approach. Much better than raising equity and keeping those assets on the book.

Kemal Dervis, Vice-président, Brookings Institution et membre du comité exécutif, Istanbul Policy Center, université Sabanci

Sometimes when overcoming one crisis you often prepare the next crisis and my question therefore is the following. We have had an incredibly long period now of very low nominal interest rates – and I mean record low nominal rates. These are not necessarily real interest rates and there have been other periods of low real interest rates. Yet the return on real capital is not low and there is therefore a real gap between the real interest rate and the real return on capital. That could be desirable for stimulating investment but it does not seem to do it. Have you any thoughts on the perpetuation of this low interest rate situation and what it may lead to?

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

That is a very good question and I have a view on it which I will perhaps reserve for later.

Jean-Claude Gruffat, European Chairman, Global Subsidiaries Group, Global Banking, for Citigroup

I have one remark to start with on the question that was raised on wealth destruction and I will take two examples. In a matter of months, Lehman Brothers went from USD80 to USD0 in terms of share price and with my own institution, Citibank, our stock price was USD56 at the end of 2006 and went down to under USD1. We, of course, were rescued, unlike Lehman. The amount of wealth destruction was therefore enormous and affected a lot of people who were not necessarily responsible for what had happened.

I would like to cover three points briefly. The first is regulation and on the topic of regulation I wonder if we are not diverging between one side of the Atlantic and the other side in the sense that if we look at derivatives, for example, Dodd-Frank looks very much at activities and instruments and European Market Infrastructure Regulation (EMIR), which is the equivalent of Dodd-Frank in terms of derivatives, looks more at institutions. Therefore, on the one hand we seem to be regulating institutions and on the other hand we are perhaps looking at the broader supervision of instruments. Whether this is something that is helpful going forward is a question that I would raise.

Secondly, in countries such as Canada and Australia, it seems, at least to me, that the crisis has been less severe than in other countries and the type of deficiencies and failures of institutions that have been mentioned several times in the discussion have not been observed. I wonder whether a unified supervision of bank insurance and securities may not be a better solution than having a kind of fragmented supervision.

My third point is the level playing field that was raised, amongst others, by Mr Ackermann. It is true that the US banks were not subject to Basel II on a consolidated basis and recently, as you know, the Federal Reserve has delayed the implementation of Basel III for US institutions going beyond 1 January 2013. Nevertheless, as you also know, 90% of US banks are effectively very large institutions that have international activities and the rest are really domestic institutions. As far as the international activities and big banks are concerned, the Federal Reserve has made it very clear, I believe in response to the Financial Stability Board (FSB), that their stress tests will be run under Basel III in 2013. This means that the biggest US banks will effectively be Basel III compliant.

Un journaliste italien

My question is on the banks and I would like to ask anyone who would like to pick this up whether you feel that the European banking system is a little behind the curve compared with the US in terms of becoming more resilient on the one hand and more efficient on the other, especially when we look at three factors. The first of these is fragmentation. Secondly, if I look at the country that I know best, the role that banks are playing is probably making the recession worse rather than better. Thirdly, it really depends on how you measure leverage, but if I look at Deutsche Bank, for instance, while it depends on how leverage is assessed, it is still approaching 40, which is a lot, particularly after what we have gone through.

Gregor Woschnagg, Conseiller du Conseil d'administration de la Fédération de l'industrie autrichienne

My question concerns the relationship between the euro and the dollar as the world reserve currency. Last year, the euro was about 26% of the reserve currency and it is more or less the same this year, standing up to all the predictions of a breakup of the euro and so on. How do you see the future? Will the dollar remain the same dominant world reserve currency or is there now a shift towards the yuan and other currencies?

Un participant

Could you comment on general inflation, which has not been mentioned this morning? What are the tools that can be used to sterilise liquidity and so be able to fight general inflation and what would be the effect of the use of those tools on the economy?

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

We also had the question on the zero rate.

Hugh Morgan, PDG de First Charnock Pty Ltd, Australia

The question that I wish to put to you is this, and this is the background to it. The banking system and the Government are effectively one at times of crisis and private debt becomes public debt, from which there is no escape. The position of the Government therefore becomes absolutely critical. If the Government finds itself in a situation where it has fiscal issues and has over-promised future benefits as well as borrowing and debt levels, it seems to me that even if the major Western countries have, let us say, a 3 to a 3.5% gross domestic product (GDP) growth rate, it is arithmetically inevitable that haircuts have to take place. The question is where do they take place? Is it going to be inflation or a future reduction of entitlements? Where is it going to be?

In that event, there is a backwash into the financial system. Therefore, whereas we talk about the financial system as if we are improving the levers at the train station marshalling yard, the real question is what is the position of the Government, for which the financial system is an essential element of survival? It is the financial system that has a vested converse interest in ensuring that the Government is behaving itself because there is an inevitable backflow.

Jacques Mistral, Conseiller spécial à l'Ifri

I will take the question on the exchange rate and will start by saying that again, as Jean-Claude as said so often on this issue, the euro was never created with the idea of being a competitor to the dollar. The two reasons at the basis of monetary union are, firstly, to have a single currency for a huge common market and therefore for the economic interests of member states and, secondly, to have a more integrated Europe in a period when Germany, with reunification, was growing in size and power within Europe.

With that reflection of the past, with the current question I will take the opportunity to raise a rhetorical question. Knowing what we know given the crisis, would we do it again in Europe? I would say yes because the two reasons are now more important than they were in the 1990s: the economic interest for the good functioning of the single market and the political interest to have Germany within the consort of European nations and not exercising its economic power in a solitary way.

The euro therefore remains on the international scene, but making any prediction about exchange rates is naturally a really dangerous exercise, so I would therefore very cautiously say that, given my analysis, the most likely development is the status quo. There is a broad demand that we have seen working for two years for a stable financial international environment and China is playing an important role in this and was working during the euro crisis, although that is a more likely development for next year.

What, then, might make the status quo change significantly in one direction or another? I can see things evolving dramatically in the US, although as I have said, this does not appear to be likely. However, it is not impossible. In effect, things might turn more and more difficult. The probability is therefore small, but it is not impossible. Secondly, on the other hand, there could be a compromise in the US in January but at that time the financial issue could become a secondary problem and with the outlook in the US, all that remains is the promise of a new start with shale gas and so on. We therefore could very well have a new differential between the US and Europe, as we had 12 years ago, with a new phase of US optimism, if I put it like that. If European Governments do not deliver on the four unions and so on, it could be a dangerous moment for Europe. However, in my view, neither of these scenarios is likely and for that reason there will be a kind of status quo.

Jeffry Frieden, Professeur, université d'Harvard

Let me focus on two very important issues that were raised by a number of speakers. One is the point that I think was most cogently expressed by Hugh, which is who pays? Who is going to bear the burden of adjustment? Every debt crisis in history ends up with political conflict over the distribution of the burden of adjustment, whether across countries in terms of debtor countries versus creditor countries, as in the European Union or other instances, or within countries, because the adjusting process always involves costs. It is politically extraordinarily fraught, largely because in most instances there is a broad sentiment, which may be accurate or not, that the people who are being asked to make the sacrifices are not those who have principally benefited from the borrowing-led expansion.

I remember being in Brazil in 1983 in the midst of their most serious debt crisis when the then military President of Brazil went on television and made a famous speech in which he said that Brazilians had to tighten their belts and understand that the party was over. The next day, there were mass demonstrations in Rio de Janeiro and Sao Paulo and the banners read 'The party's over and we weren't even invited'. Whether it is Europe, North America or elsewhere, there is a broad sense that that is exactly what has happened. If I had time, I could give you numbers about what happened with the distribution of income growth in the US during the expansion, which was very heavily skewed towards the top 5% of income distribution, and then the distribution of the costs of the recession that ensued, which was very heavily skewed towards the bottom 50%.

I think that that is a crucial question and in Europe it takes a different form, but also within countries; there are debates in Germany as to whether it should be the financial institutions, taxpayers, beneficiaries or public sector employees and so on. I think that this is a crucial question and it was also raised in some of the other questions as to whether financial institutions have taken a big enough hit.

There are many technical economic issues associated with this but I think that the underlying political reality is that one of the reasons why we have not made more progress in addressing the underlying causes of the crisis and particularly in resolving the debt overhang that has dragged down all our economies is that there is no political consensus, and this is obvious in both Europe and the US. We are engaged in a whole series of games of chicken where each side is holding the other hostage, trying for a better deal.

If we know anything about the resolution of debt crises, we know that the longer resolution is delayed the costlier it is. Therefore here we are in a situation, such as that of the US, where very strong positions on both sides are leading to political paralysis or gridlock, which is impeding a longer-term resolution and raising the costs of the ultimate resolution, and I think that that is exactly the situation in Europe too. We have already lost one decade – the past decade – where anything that was realised in the expansion was wiped out by the recession and I think that we are in serious danger of losing another decade as political gridlock makes a long-term resolution of the crisis very difficult, if not impossible. For me, this is the crucial nexus of the current problems that we face. That is the first point.

There is then a related point, which Kemal has very accurately identified and I think raises a lot of interesting questions. In many ways, we have done extremely well – and this goes back to something that Jean-Claude said at the start – in the stabilisation period of the crisis and Central Bank intervention and some fiscal and other policies have done a very good job at stopping the bleeding. However, despite the fact that it is now five years since the beginning of the recession, we have not been able to move forward to what would typically be regarded as the adjustment phase, when economic activity starts to return to normal.

Financial institutions and systems are not playing their normal role in intermediating between savers and investors because they are so preoccupied with the trillions of dollars of debt on their books that they either know to be bad or fear may be bad. It is not that people are being evil; it is that the underlying situation and paralysis in many policy areas has made it difficult, if not impossible, for financial markets, the corporate sector and the household sector to return to normal economic activity. I think that that is why, as Kemal pointed out, we have zero or negative real interest rates in the short run and extremely little indication of a recovery of normal investment behaviour in the medium and long run. I see those two phenomena as two sides of the same coin. Until we have achieved a meaningful long-term resolution to the debt crisis and the debt overhang we are not going to see the recovery of normal economic activity. That is the challenge that I think both Europe and the United States face.

Marek Belka, Président de la Banque nationale de Pologne

One of the key questions here, among the earlier interventions, is the cost and who is going to pay. I will be here quite cynical. We have to find a way that is politically most acceptable, and what that is, firstly, is ultra-low interest rates combined with a surprisingly high profitability of financial institutions. This is the way in which the society decides to deal with banks and other financial institutions. If we cannot live without them as they are, we have to strengthen them. Therefore: “Let the savers pay, whoever they are”. That is my first caustic remark.

Secondly, we have inflation. Unless it gets out of hand – and I know how difficult it is to say that, especially in the presence of Jean-Claude Trichet – inflation is obviously the least obtrusive way of taxing society. There is a stark contrast between Europe and the other most advanced countries in the way we seem to be afraid of inflation, while the other countries are not. What will come out of this is another question and it is a question that should be directed at Jean-Claude. Do we know how to mop up excessive liquidity if the time comes to do so? That is another question.

Reduction of future entitlements was mentioned and this is a specifically European question. There are countries in Europe, including my own, that decided to cut future retirement benefits, basically, by half. This was possible because the public was ignorant of it and the politicians were ignorant as well or did not care about it since the reduction would take place in 20 or 25 years’ time. Moreover, it was a conspiracy of “well-wishing” reformers and some not-too-deep-thinking politicians. We are now waiting for it to come. What will be the people’s reaction? Will they revolt when they realise that their future entitlements have been reduced by half, and their pension will drop from 60% of their final income to about 30%? While we can modify the outcome by extending the retirement age – which we did – and do something by stimulating retirement-related savings, that is just a small modification of the main operation that was carried out about 12 years ago in Poland.

Poland’s long-term fiscal sustainability is probably one of the best in Europe and possibly even second to none in Europe. However, what will happen in 20 years’ time? I will not be active in my professional or political life then. It is an experiment on a living body.

The last thing is the issue of the euro versus the dollar and other currencies. Let me comment on this from the perspective of the governor of central bank who has the authority over relatively large foreign exchange reserves. Poland’s reserves swelled, as in most other cases, to over 20% of GDP, which is probably way beyond what we need. However, it happened indeed, so we have to do something about it. It is a challenge because anything that comes close to what we call safety is basically loss making.

If you decide to invest in dollars, what you are really choosing to do is to assure a capital loss in the years to come. Are you going to invest in Brazil, Mexico and China? What we do is diversification. We are heavily overweight in euro compared with the international average, which is obvious because of our location and trade flows. We are also overweight in other currencies. Although, when we look at our euro investment, we realise that sometimes it has nothing to do with euro investments. We invest in the core euro – "euro plus". We do not have the euro; we have "deutschmarks" and "French franc" as well as some other minor currencies. That is why we are so interested in stabilising the eurozone and being able to invest in the real euro again.

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

Thank you. Implicitly, you were fishing for compliments a little as Prime Minister and not as a Central Banker and I can compliment you on that. The current resilience of Poland and its remarkable stability that we have all observed is due to the very tough decisions that were taken in the past. Therefore, bravo, if I may say so.

Joseph Ackermann, Président du conseil d'administration, Zurich Insurance Group Ltd ; ancien PDG, Deutsche Bank

Let me start by emphasising that real estate bubbles and debt crises always take much longer to correct and are much costlier in terms of growth and employment than other bubbles or crises. Some countries have a real estate bubble, which will take years if not decades to correct itself. We have seen this in Japan and many other countries. To pay for a house or apartment represents a sizable amount of one's income, and they are not homogeneous goods. So it takes a longer time to find buyers and a new equilibrium.

Inflation, not only in Germany, but also in other countries in Europe, is an emotional as well as a political issue. That is why I do not think that inflation can or will be the solution for our debt problems. We see that the monetary basis has increased but money demand has not and therefore we are not in an inflationary environment. However, as both Jean-Claude and Marek said, when the economy starts to pick up – we are not seeing it yet – it will be very difficult for the ECB politically to start reducing liquidity in the market.

The second point I would like to comment on is leverage and Deutsche Bank, I have to respond to that question. It is a perfect example for the confusion raised by the different accounting standards. Deutsche Bank's balance sheet under International Financial Reporting Standards (IFRS) is about 2 trillion Euro. Under US Generally Accepted Accounting Principles (GAAP), it is about 1.1/1.2 trillion Euro. Therefore Deutsche Bank's leverage compared with US banks is about 20; under IFRS, it is 40. This huge difference results mostly from the fact that the derivative book is accounted for on a gross basis under IFRS and on a net basis under US GAAP.

By the way, leverage of US banks is also lower because they have a huge capital market. Their financial system is more market-based whereas the European system is more ban-based. Most European countries still heavily rely on lending. As I mentioned before I just attended a meeting of the advisory council of the Chinese banking regulators. Among other things we discussed whether China should move from a bank-based system to a more market-based system. Lending cannot go further up with the new regulatory requirements. That is why I think that we have to establish stronger capital markets in Europe as well and we have to ensure that the securitisation market comes back so that we are better positioned for funding the real economy going forward.

The next point I would comment on is the fragmentation of the European financial sector. Yes indeed, we are highly fragmented. If I remember correctly, about 75 percent of US banking profits come from five banks, which is of course much more than in Europe. Banks are very fragmented and very few of them are in the top league in terms of market capitalisation and now Chinese, Brazilian, Canadian and Australian banks are ahead of most of the big European banks.

I'm not saying that European banks are weak. I'm just trying to say that reality is complex. I think that we are both more or less at the same level with US banks if you compare apples with apples.

Finally, let me say something on the rating agencies. I am in favour of some oversight and making incentive schemes transparent. However, on the other hand, what would we rely on, if we did not have some kind of rating agencies? We can be as critical as we like of financial markets but without the signals that led to a credit spread widening in Greece and other countries their debt build up would have gone on even longer and our problems to deal with in the future would have been all the bigger.

Things must be transparent, excesses must be prevented and properly dealt with if when they occur, but let the financial markets do their job. They're a good thing to have.

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

I could not agree more on what you have just said, unfortunately. We had all the figures on the way Greece was developing and on other countries in the European Union (EU) area. They were given to Ministers every month and as long as the market did not react there was absolutely no move to prevent what could happen. However, the problem with the credit rating agencies is also that, at the start of the crisis, they were the followers of the market and not the leaders, which is of course a problem because they had been slightly pro-cyclical.

I would just like to say a word myself as a speaker. First of all, this issue of equity versus loans is absolutely decisive. As I have already said, in the G30 we considered it to be the major problem that needed to be examined now and I have to say that it is true that Solvency II appears to be totally counter-productive, as are a number of other rules and regulations. It also seems to be the spirit of many new regulations that we have in mind to call for as much liquidity and as little risk as possible, which of course is not the characteristic of equity.

My second remark is that I am struck by the fact that all the advanced economies that resisted so admirably in the crisis – and I am speaking here about the real economy – whether it was Sweden, Canada, Germany or wherever, all had had enormous problems. For Canada, it was the end of 1980s, when they had to put their house in order and did so magnificently. The Swedes and Scandinavians had problems at the beginning of the 1990s and Germany had the problem of reunification. In these three cases – and I could quote others – there was an extremely [inaudible] adjustment which proved the countries to be admirably resilient in the circumstances.

As regards inflation, low rates and the danger of there being the recipe for a new crisis, I think that this is a real issue. At the very beginning of the crisis, the consensus was to say that it was the accommodating monetary policy that had created the situation of a dramatic bubble as well as overhang of debt and so on and that the Central Banks were more or less responsible for that. We then had the crisis and all the difficulties and there is now more or less a consensus that says that the Central Banks have to do exactly what was considered to be the cause of the previous crisis and must supply liquidity on an unlimited basis and have zero rates for this year, next year, the year after that and the year after that.

This is of course a little intriguing, but let me comment as a Central Banker. Firstly, in my own perception, the non-standard measures that were taken on both sides of the Atlantic are totally different because, as Joseph said, the structural refinancing of the economy is totally different. The economy in the US is financed through markets and, not surprisingly, the Federal Reserve concentrates on markets and the outright purchases of securities in order to have markets that are as well oiled as possible and that function as well as possible. In our case, we have an economy that is financed by banks and, not surprisingly, the main tool that we have utilised has been the unlimited supply of liquidity at a fixed rate, provide of course that there is appropriate collateral.

There are therefore two different tools but the result is the same. On both sides of the Atlantic, we are more or less allowing intermediation in the widest sense of the term to function better because it would not function spontaneously normally. We are therefore substituting an intermediation that does not function normally in markets that would not function as we would hope.

In my interpretation, this is perfectly legitimate because we are doing what is necessary for the monetary policy standard, namely extremely low interest rates, to be channeled to the real economy and not hampered by the absence of the normal functioning of markets. As long as we are in this situation, it seems to me that this is legitimate. Of course, we also need to send out messages to the private sector, and I entirely share the view that we need to tell financial institutions to put their houses in order and be as strong as possible. We then come back to Joseph's remark that the market itself is pushing very forcefully in this direction.

I am amazed when I reflect on our own meditation in 2009 in Basel when we were saying that we have to be sure that in the long run the system is resilient but that we should not hamper the recovery so let us have a long-term vision of what we need to have in 2017, 2018 or whenever and then ask the commercial banks to do that. However, the market said that they wanted to have immediately what we were foreseeing for 2017 and 2018, and the market won, of course. We realised that we had been extremely abstract and theoretical in our understanding of the real influence that we could have as supervisors.

On the mopping up of liquidity, I have no problem with that. To the extent that we are not overdoing what we have to do right at this minute, namely to counter an abnormal functioning of the private sector to the extent that the private sector would be back on its feet again and that intermediation would again function normally, there would be no problem in withdrawing the non-standard measures. By the way, as you know, we supply liquidity on an unlimited basis, but liquidity comes back into the accounts of the Central Bank. It is therefore really a substitution to a system that does not function normally and I am not too pessimistic about our capacity.

Regarding interest rates, I consider the present level of interest rates in Europe to be absolutely correct and if there were any moves, they would be justified take into account the situation. However, to commit to three more years of zero rates seems to me to be extraordinarily dangerous because we do not know what might happen in the long run. Again, if the non-standard measures themselves are precisely about channeling the right and appropriate interest rates then it seems to me that we should decouple the standard and non-standard measures more. We have a separation principle in Europe which seems to me to be appropriate. By the way the Federal Reserve permitted the disconnection of the non-standard and standard measures because there is now a possibility of remunerating the reserves, which would allow them to continue to be very active in the purchase of treasuries and securities and have higher interest rates than the close to zero level.

There were two or three other points. I share Jeffry's view entirely and understand Jacques' point on the absolute need to have real governance of macro policies. I am totally convinced that we were in a dramatic anomaly with the poorest countries financing the wealthiest, which is not normal. By the way, we are probably experiencing the first crisis of the advanced economies to be more or less like the Latin American crisis and other crises, namely that the rest of the world is telling us that we should not perpetually spend more than we earn. That is a very simple message and it is obviously a very tough one, particularly for some advanced economies. However, it is a message that is not really being received, particularly in some of our economies.

The austerity versus growth debate, for instance, that we have in Europe seems to be very bizarre when it is applied to individual countries. When you are in a country that has lost its credit worthiness the most important recipe for growth and job creation is to get back to credit worthiness. Otherwise you are permanently hampering the confidence of everyone – investors, savers and so on – and cannot provide the appropriate environment. I was struck by the remark made earlier on the USD530 billion of current account surplus that would be in the set of what might called the northern European advanced economies, including Switzerland, which is of course a substantial part of it, and it all means that there is room for manoeuvre in parts of the advanced economy, which seems obvious. By the way, normally, if the market economy functions, it should function. We can see this in Germany where the new negotiations on wages and salaries are totally different from the previous ones, for obvious reasons, and this could of course play a positive role in the overall integrated euro economy.

I will conclude on the euro/dollar issue. It is true that the euro as the currency of the euro area as a whole is backed by fundamentals that cannot be challenged. The current account is not imbalanced, as is the case in the US and the UK. Price stability for all countries, including Greece, Portugal and Ireland, has been maintained at 2% over 13 or 14 years, and that also cannot be challenged as the currency of that region. The yearly deficit of public finances is half that of Japan, the US and the UK. Again, therefore we are in a situation that is highly paradoxical because we have both a consolidated euro area, which is not doing magnificently, but is in a better situation than other advanced economies, while at the same time we are concentrating on the most vulnerable signatures of the advanced economies, or at least those signatures that had been considered to be very vulnerable. This is the paradox of the euro area. However, it is true that since the start of the worst crisis since World War II and which could have been the worst since World War I we have had the level of the euro against the dollar that has been constantly higher than the entry level, which was 1.17, despite all the rhetoric.

The rhetoric does not therefore capture the reality. A lot of politicians are saying that we are fighting to avoid the breakup of the euro and so on. That is not the case. As a currency, the euro is there. The problem is that we are trying to avoid – and we are succeeding – the disruption of the euro area as a whole and the problem with some parts of the euro being in an extremely difficult situation. However, we should say that we are doing all this to allow the set of economies in the euro area to function better and have fewer problems and tensions. However, I suppose that for political reasons to say that you are defending our currency is more inspiring, particularly when you are speaking to your own Members of Parliament (MPs) than a more complex way of expressing what is being done. However, again the paradox is quite striking in that respect and I was responding to the ambassador in particular on that point.

We have the privilege of having so many angles of vision and so much wealth in the remarks that we could go on, and I am sure that we have other questions.

Un participant

Being an industrialist and a financial person I wanted to ask a question about the balance between the financial and the non-financial worlds. I do not say the ‘real economy’ here because I think that the financial world is real as well. In the last 20 years, the financial sector has grown enormously in size and in profits in terms of its share of the total profits of the economy and it has grown enormously in political power and how it attracts people, with the best people everywhere going into the financial sector. It has grown in intellectual attractiveness and most academics have not questioned the fact that the market was the answer to everything and so on. I think that it was the British regulator who said that the financial sector had a case of hypertrophy.

I therefore wanted to ask first of all whether you agree with that. Is it a relevant question or a stupid one? Going forward, are we seeing any signs that, if you agree that there was an imbalance, things will rebalance or do you think that sometimes when we look, especially at the US, it seems as if Wall Street is going back on the same track and that not very much is going to change? The people from Harvard have not been going to banks as much in the last two or three years but they are going there again now. What do you think about this question of balance between the financial and non-financial sectors?

Un participant

My question is a more technical [inaudible] on monetary policy and is about the constraints of heterogeneity of the financial institutions on the action. Jeffry mentioned that there is a trade-off and that it is very difficult on the two sides of the Atlantic because of those differences to have a common set of regulations and that it is better to make the trade-off of coordination of policy. However, if I apply this issue to the euro zone, I think that there are also heterogeneities of institutions within the euro zone and it is very difficult to consider a different set of regulations in a currency region. Pure monetary policy does not change the change of structure so how can we reduce the heterogeneities, probably through more direct action, in the eurozone?

Jean-Claude Trichet, ancien Président de la Banque centrale européenne

Thank you. Just for the record, the only point where I would defer from Jeffry is precisely on that. I think that it would be dramatic to go back to the renationalisation of the rules and regulations and prudentials and we would destroy what was started during the time of the first Latin American crisis when we invented Basel I. However, we will come back to this.

Sean Cleary, Vice-président de la Future World Foundation et président de Strategic Concepts (Pty) Ltd

With a view to the discussion that you are going to be having on the issue of the restoration of trust and confidence, I would like to throw in a provocative observation. In terms of the introduction this morning, in highlighting the areas that still potentially pose problems in the system – the fact that shadow banking is still largely unaddressed and that there is a migration in that direction and that we do not have any appreciation of the cumulative impact of the regulations that we are bringing to bear and the issue of jurisdictional diversity, which has been referred to many times, and the whole question of the greater concentration of risk as a consequence of the restructuring in the banking system – Joseph highlighted a number of the underlying challenges, which explain in part and not in whole – and there other issues which have been adequately canvassed – why we have not moved adequately from stabilisation, where we have been highly successful to economic readjustment. Jeffry's point about the overhang in respect of both debt and the real estate bubble self-evidently explains that to an appreciable degree but it does not tell us how we are going to get out of it.

If you then, as a whole, take this system as one that is reasonably being characterised as afflicted by moral hazard, with high levels of contagion and, related to the whole, a significant degree of regulatory arbitrage currently built into the system then it is not self-evident why we have a great system. It may be better than the others but it is not intrinsically great.

I thought that Jeffry then developed that point further effectively by arguing, in effect, for the merits of global finance, but with the equivalent costs of global finance, which are intrinsic in the experience that we have just had, not least because macroprudential oversight is unbelievably difficult. It seems to me to be marginally improbable that the extrapolation of the instruments that we apply at the microprudential level to the macroprudential level is the solution to that problem.

Part of it is the huge diversity of markets. The Lebanese intervention was interesting in the context of the whole debate because what the speaker was grappling with was a completely different set of challenges. The way in which hyper-logarithmic instruments impact on the Lebanese economy is completely different from the way that they impact on the US economy or even on Deutsche Bank and the way in which a rating agency treats a Lebanon is completely different from the way they treat a General Motors or a Citibank.

All of those factors go to the great difficulty implicit in what Jeffry was arguing for, which is essentially macro policy coordination, and the reasons why that is extraordinarily difficult were very well outlined by Pascal Lamy yesterday evening. There are different interests, scales and prioritisations of values and no agreement on what the normative system would be. Therefore the underlying question behind all of this is 'Are we still completely persuaded, recognising all the benefits associated with a global financial system, that we actually know how to manage it?'

Jean-Claude Trichet, ancien Président de la Banque Centrale Européenne

What we could add is that we learned the hard way that we were all inter-connected and there were a lot of externalities, despite the fact that the Westphalian sovereign states are still there.

André Lévy-Lang, Professeur associé émérite à Dauphine, Président du Conseil de Surveillance des *Echos*

I agree with Jeffry's comment that the harmonisation of financial regulation is unlikely to go all the way bit I think that it is needed, if only to make sure that there is a level playing field. However, there is a paradox. Jean-Claude mentioned that when looking at how non-standard measures were taken by the Federal Reserve and European Central Bank (ECB) they took into account the fact that the structures of the financing of the economy are very different between Europe and the US. Nevertheless, when you look at the impact on the economy of financial regulation for both banks and insurance companies you see that it has tremendous importance in terms of this impact. In Europe, the way we apply Basel III and Solvency II rules means that there will be a real problem in terms of financing long-term requirements for investment both in terms of debt and equity. We will see this happen.

Therefore how can you take this fact into account when on the one hand we want to have a level playing field while on the other we have to take into account the fact that the structures are different? There may be something that can be looked at in terms of the way it is applied in the implementation of regulation and I think that that should be one of the questions that is raised when looking at banking union in Europe and how we can make sure that having a level playing field and applying Basel III – and applying it quickly, as Joseph mentioned, because of market pressure – and applying the rules that we have decided on for making sure that we have a playing field does not have a very negative impact on the financing of the economy, specifically in France, on the long-term rates?

Jean-Claude Trichet, ancien Président de la Banque Centrale Européenne

I do not see why it should specifically affect France.

André Lévy-Lang, Professeur associé émérite à Dauphine, Président du Conseil de Surveillance des *Echos*

This is not the topic here, but we have a tax system now that has a strong impact. That is another point.

Jim Hoagland, Conseiller de la rédaction du *Washington Post*

I have a question for Jacques Mistral. You told us that Japan is the problem that we should be worrying more about. Tell us why.

Donald J. Johnston, associé fondateur, Heenan Blaikie; ancien secrétaire général de l'Organisation de Coopération et de Développement Économiques (OCDE)

I was not here for all the discussion on the rating agencies but I raised a question with Jeffry at dinner the other night. I am surprised, if it has not happened, that there has not been a move to establish an inter-Governmental organisation – which could be the International Monetary Fund (IMF) or the Organisation for Economic Cooperation and Development (OECD) or something else – to deal with sovereign credit ratings. I think that the credit rating agencies deserve a lot of blame for the crisis and they lost their credibility in the subprime debate. For example, there is the export credit consensus at the OECD where countries rate the credit of non-OECD members in terms of exports, taking into account a whole cross-section of issues such as experience with the private sector and so on. I am surprised that there is no move to establish a body that would deal with sovereign credit rating.

Pawel Wojciechowski, Ambassadeur, Représentant permanent de la Pologne auprès de l'OCDE

I was glad to hear about the OECD just now as I am the permanent representative of Poland to the OECD. Every time that I listen to this discussion – and this is an excellent one – I try to figure out where the space is for national coordination and I really appreciate Jeffry's audacious comment, which I read as him being less hopeful for harmonisation on financial market regulations than for macroeconomic coordination. That is how I understood it. He is [inaudible] on the harmonisation of financial markets. He described balances and international capital flows very well, which could be perceived as a problem that could be raised for coordination at the national level. However, some people would consider this to be a purely domestic issue of dealing with the internal balances of savings, investment and consumption and that it should be left there.

My question therefore is not only what but how and where this coordination could take place. We have heard a number of comments made that it was addressed at the G20 but failed. There is therefore the question of where and the imbalances and the EU procedure and whether it would be a good idea to think about this as a tool.

John Lipsky, Distinguished Visiting Scholar, International Economics Program, The Paul H. Nitze School of Advanced International Studies ; ancien Premier Directeur général adjoint du FMI

I have two questions, the first of which is on the level playing field. As is typical in these kinds of cases, we talk about financial regulation, which I assume is shorthand for a broader set of issues – regulatory issues, including perimeter issues; supervision; resolution; and the area of assessment. I do not think that it was ever expected that harmonisation meant that everybody did exactly the same thing. Harmonisation meant that everybody would do the appropriate thing that would help create a level playing field.

As part of that effort, an explicit initiative was undertaken in terms of assessment of the efficacy of the effort and its implementation, which was the making mandatory of the periodic financial sector assessment programmes of the IMF and World Bank on all G20 members. In addition, there is the new FSB, which we have to remember has been in existence for all of three years. It took 12 years to negotiate Basel II and in that context the FSB is still a very new organisation for running a peer review process.

Is the commentary then implicit that that assessment process, which is aimed at enforcing harmonisation, is in effective or is the implicit view that it is too soon to tell? The bottom-line question is therefore, as a result, do the panelists consider that the playing field, as it were, has become less level since the crisis because of the reform efforts? That is one major question.

My second question is on macro policy coordination and Jeffry alluded to the multilateral consultations and global imbalances that were held in 2006/07 and disappeared more or less without a ripple. That is a topic that I could talk about at some length, but it has been subsequently succeeded, as it were, by the G20's framework for strong, sustainable and balanced growth in the Framework Working Group, whose work is extensive but virtually unknown. The Los Cabos summit adopted the Los Cabos Action Plan for specific measures in all G20 economies on policy coordination and the newest ripple is the creation of an accountability process to ensure the actual implementation of these efforts in the medium term.

Is the scepticism expressed about this process a comment on the substance of the Los Cabos Action Plan, namely that even if it was implemented, it would fail or is the plan appropriate? Therefore, is the commentary not on the plan itself but the effectiveness of the accountability process or is there simply a lack of knowledge about what is going on, reflecting the lack of high-level political commitment to this process?

Jean-Claude Trichet, ancien Président de la Banque Centrale Européenne

Thank you, and I have to pay homage to what you have done to improve global governance in the IMF.

Il Sakong, Président de l'Institute for Global Economics ; ancien ministre des Finances de Corée

As regards the macroprudential dimension, I just wanted to bring more attention to the aspect of global economic governance. I do not know whether we have anyone from Brazil here but at the next meeting of the G20 Finance Ministers I think that the quantitative easing 2 (QE2)/QE3 issue will emerge again and they will then talk about capital market controls. Even the IMF admitted recently that some form of capital control may be inevitable, particularly for small open economies. Unless there are protection mechanisms at the global community level from these volatile capital flows then individual country-level measures have to be taken.

As the main theme of this conference is global governance, I think that we should spend more time as a global community as a whole on how to deal with this critical issue. On the one hand, everybody would like to see the US, Japanese and the major economies doing better; on the other hand, if these non-standard measures are used, people will say that they will hurt their economies. How can you then solve that problem?

Another point that I would like to make is that, as Jeffry emphasised, macroeconomic policy coordination is very important. However, we have to pay attention to the G20's Mutual Assessment Process (MAP) process. The process is there through the Mutual Assessment Process. Even with the eurozone crisis, the major European countries are members of the G20 as a group and if the MAP is implemented, based on, for example, the Korean experience in the 1997-1998 period, it is always very helpful for policymakers to have externally imposed conditionalities. This would de-politicise the very difficult implementation of structural adjustment policy.

I would therefore have thought that European countries would take advantage of this because domestic policy is always the greatest obstacle and in that regard again the G20 process could be utilised.

Jeffry Frieden, Professeur, université d'Harvard

Firstly, on inflation, as the only American on the panel I feel an obligation to defend American monetary policy. We have been at the zero interest nominal bound for a long time and the fact is that the latest Federal Reserve study has shown that at the trough of the crisis the appropriate Taylor rule would have implied a nominal interest rate of -6%. In the current situation, the Taylor rule implies a nominal interest rate of -2%.

Monetary policy in the US is aimed largely at pursuing two goals. The first is a reduction in the real debt burden by trying to raise inflation. We do not have the benefit of a sovereign debt crisis, as there is in Europe. Europe can restructure sovereign debts; we cannot restructure 30 million mortgages. The only way that that can be done is by trying to get a little bit of inflation into the system. The second thing is to try to change expectations on the part of producers, which is what the three-year commitment is intended to do. Monetary policy in the US is therefore pursuing those goals. We have different conditions from those in Europe and I think that US is doing it effectively.

On regulation, I did not mean to imply either that we should renationalise finance or that there should be no attempt to work out more harmonisation of regulation in the euro zone or elsewhere. I am all in favour of trying to harmonise regulation but we have limited political capital. This is an extraordinarily difficult achievement. In the US, we have been trying to harmonize financial regulations domestically – among the fifty states – for a hundred years, and we are still only part of the way there.

Jean-Claude Trichet, ancien Président de la Banque Centrale Européenne

[inaudible] at least the theoretical concept, which is now at stake, even if it is difficult to implement. Basel III was worked out in about a year and a half, and that was incredible, to be frank. We could therefore be very positive regarding the immediate lessons taken from the crisis. We have also of course noted that it is very complicated. Macro policy coordination, despite the conceptual breakthrough, is still extremely difficult, but I would say that there is nevertheless something underlying it all and some diminishing of part of these imbalances is taking place under the pressure of the crisis itself and the market.

As regards the prudentials, while a lot has been done it is true that we are fighting against a completely adverse trend that calls for renationalisation, financial mercantilism, if not mercantilism in general, regulatory arbitrage and so on. To the extent that we are speaking about global governance, we still need a global economy because if we renationalised everything, we would potentially lose enormous wealth. The emerging world has been helped wonderfully by globalisation, but the advanced economies would have to lose a lot if there was renationalisation or concentration on the various continents because the source of growth in the medium and long term of course remains in the emerging world.

I am not sure that we can therefore draw any conclusion and our rapporteur will see what he can do with all that. History is not written and it will depend on all of us and our sovereigns first of all. All our democracies have been electrified by this crisis and are calling for full responsibility to be taken.

This has been fascinating. My thanks to all the speakers.