DANIEL DAIANU

Member of the Romanian Academy; former Minister of Finance of Romania

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed Aso san. I can tell you that you are a very effective advocate for your economy. Thank you so much.

So, I turn now to Daniel Dăianu and we expect some views perhaps on secular stagnation but also on other things.

Daniel Daianu, Member of the Romanian Academy; former Minister of Finance of Romania

Thank you Mr Chairman. I will start by making a few preliminary remarks, which portray a highly complicated economic and political world environment. Firstly, the core of the industrialised world is in a very uncomfortable and historically unusual situation. One reason is that the big financial crisis has not come to an end. There is also a very serious Eurozone crisis, which was alluded to by Jeff Frieden, and which continues to cause many worries. And last but not least, it is a shift in the global distribution of power, not only of economic power, which is not of recent vintage, but which can be speeded up by the current cluster of difficulties.

Secondly, we see in the realm of central banking and in what economic policy makers in Europe and across the Atlantic are experiencing a breakdown of cognitive and operational models. For instance, the fall of the paradigm which saw price stability as bringing about, quasi-automatically, financial stability. In the wake of the eruption of the financial crisis some remark, as Jaime Caruana and BIS experts do, that the Great Moderation has caused massive resources misallocation. This is why highly negative real interest rates are, arguably, necessary in order to achieve full employment. However, to do is a mission impossible when inflation is very low, not to mention deflation. There is also dysfunctional finance, in spite of the repair which has been taking place in recent years and significant attempts to reform the regulation and supervision of financial markets.

Thirdly, it is an issue of a lack of effective policy coordination. Sure, one can highlight the importance of events like central bankers' conferences, as the one in Jackson Hole, the G20 meetings, with the last one taking place recently in Brisbane and which referred to too big to fail financial entities. Nonetheless, there is still much to do in this regard. And I think IMF top people are right to note that, when it comes to implementing policy coordination, we are very far away from target. This coordination is important since we are navigating in unchartered territories with regard to policy making, a fact that is amply illustrated by wide-spreading use of non-conventional measures including quantitative easing. And we need to make it in such a way that, what Olivier Blanchard calls, 'dark corners', 'coins noirs', are avoided. This financial crisis is very much a dark corner and we are still with our back against the wall in many respects.

Fourth, there is, in not a few countries, a growing disconnect between people, the social body and policy makers alias the political class. This is very annoying and worrisome. In Europe, this state of affairs is not of recent vintage, for the fracture between Brussels eurocrats, national politicians and national electorates has been highlighted for quite a while. But in periods of despair and inability to achieve economic recovery, to boost growth rates, all this can be quite inimical to democracy. If you look at the constellation of political groupings in the European parliament, at the rise of extremist parties, on both the left and the right political spectre, which are basically rejecting the European project, then we have plenty of reasons to be worried in the years to come.

And finally, I remind to all of us what Robert Reich and Edward Luttwak pointed out years ago, when they talked about an age of insecurity due to the way our societies, under the impact of new technologies, the rise of income inequality and the pressures of globalization, are evolving. Paul Krugman talked about an age of diminished expectations, which is another way to describe the world we live in as one of increasing uncertainty. Extreme events keep us under constant pressure. All this is very bad because there are economic, institutional, social, and political entailed costs; these costs show up in individual mindsets and in the collective psyche of people. The bottom line is that it is very uncomfortable to lose benchmarks, guidelines, not to tread on solid ground.

Now, let me say a few words on what you suggested I should focus on, what some people call "secular stagnation" –a notion used by Alvin Hansen in 1938 and that was resurrected by Larry Summers at an IMF conference in 2013. In this respect, one needs to distinguish between lower growth and secular stagnation. For instance, Robert Gordon argues that lower growth is inevitable because of the nature of technological change, demographics, etc. which is a view I tend to share. And there is another view (Joel Mokyr, for instance), which argues that we are in the midst of an industrial revolution, that we should not underestimate the power of technological change and its impact on our economies. On the other hand, if the fallout from the current crisis is put aside, there is the reality of slower growth in the past couple of decades; there is a long term slowdown. Now the big question is whether this can turn into a secular stagnation, which is very dangerous for some of the reasons I have already mentioned. Secular stagnation would be linked with effects of the Great Recession, and the misallocation of resources which has been taking place during the Great Moderation decades, with the patter period of time bringing the global financial cycle thesis in the picture. There are dynamics which can give us clues about what is likely to happen. Thus, the Great Moderation period was supported by particular policies, among which easy money, and was accompanied by what could be judged as misleading statistics. We had a very long boom, sustained by a lot of borrowing, and now we have the bust; so, it is not clear to what extent that period of economic growth was solid. It may be that the financial cycle was diverted from its normal course by inappropriate policies. In addition, there is need to look at what I call dysfunctional finance, with oversized banks, which are extracting undue rents from the rest of the economy. Just think about the share of profits held by financial corporations in overall corporate profits in the pre-crisis years; this share does not make sense, it is ridiculous, and it has contributed to resource misallocation, to a lack of investment in infrastructure, to the lack of investment in R&D, to rising income inequality. Then, there is demographics, which is not favourable at all in Europe; there is an ageing of population and an income distribution which does not enhance economic growth. The income distribution-economic growth nexus is a critical one. I make this assertion for, a long period of time, economic growth modelling was based on the trickle down vision. More recent empirical data (see work of Thomas Piketty, Emmanuel Saez, of IMF and OECD experts) indicate a connection between income inequality and economic growth; fairness too plays a role in this equation, and it can be related to corporate social responsibility, to ethical issues. There is also high indebtedness, both public and private in the industrialized world, which can be linked with the global financial cycle. High indebtedness would ask for correction. But how the latter is done is essential. Unless it is done in a proper way, it can get the economic system stuck in a low equilibrium. Unfortunately, clear recipes are not available in this respect. Can one rely on sheer market forces to produce the correction and induce economic recovery? Or there is need for public policies that should prevent intense hysteresis phenomena and the bads of debt deflation. Larry Summers, is quite sceptical about an optimal solution; he sees a trade-off between policies that try to resuscitate economic growth and financial stability. Where I part company with what Jeff Frieden has mentioned is that, in Europe, over borrowing has taken place primarily in advanced economies and there is a lot of over-borrowing by the private sector; it is not only governments which are heavily indebted, not least due to the need to forestall a meltdown of banks. Who is going to undertake this correction? Because there is a lot of over borrowing, of indebtedness in the Netherlands, in Germany, too. So, it is not only a matter of making a deal between creditor and debtor countries. I think this issue goes more profoundly.

In the Eurozone, policy making and dealing with the range of formidable challenges is much more complicated because this area does not have proper institutions. The banking union is a possible way out of a range of major difficulties, but it demands adequate fiscal underpinnings. A "fiscal capacity" as suggested by former the former president of the European Council, Herman van Rompuy, and which implies resource transfers when these are needed, would be a means to deal with asymmetric shocks. Let's not forget that deflation is not something looming on the horizon; it is already a reality in several countries in the Eurozone. What is going to happen if we end up with the three zero's? No growth, deflation and the zero lower bound. Monetary policies are terribly ineffective currently. And un-conventional measures, such as quantitative easing, have their limits too. Therefore, I believe the urgency in the euro area is much bigger and, with all due respect for what the European Commission is trying to do, the Juncker programme has, arguably, to be more daring; there is need for massive public investment, genuine new money, for public investment can crowd in private investment. Clearly, the private sector is very risk averse, it is over indebted, and so someone has to provide the drivers and be daring.

So, to conclude, there are two conflicting views on how to cope with the current crisis. One view says, 'Look, let us let markets do the trick, even if there is a painful and costly catharsis and most of us get burned, but in the end things will move up again. This view is, to a certain extent, buttressed by a so called Basel view (Claudio Borio and others), namely that if there is too much stimulus and low interest rates, seeds of a new crisis are activated; it is the financial cycle vision. And there is the other view that says, 'look, we cannot be oblivious to the peril of having such a low aggregate demand and big unemployment. Huge unemployment is socially and politically not acceptable and we can be stuck in a very bad equilibrium unless something is done about it'. I believe that both trains of thought have serious arguments. But I would rather side with the view that we need to be less risk averse regarding policy making in order to avert a disaster in Europe.