

DEBATE

Jean-Claude Trichet, former President of the ECB

Thank you very, very much for forcing the discussion, I am sure that you will have occasions of intervening. Thank you very much for this introduction.

Let me make two remarks from my side; first of all I think that on the political aspect of the situation, in the advanced economy and in Europe, I think that the idea that Europe is rejected that it is very clear that it is visible in the extremist sensitivities, political sensitivities that are as you say in the open parliament and also in all polls. I would nuance that a little bit. First of all it seems to me that we have the same phenomenon in many advanced economies. The Tea Party in the United States of America, the Independence Party in the UK, they are not in Europe as regards America, the UK is not in the Euro area. I would say there is 'malaise' in the advanced economy which probably has very profound reasons and which is underlying, and I also draw from another survey, the conclusion that it is a malaise vis a vis all leaders and institutions because when you look at the last polls in Europe which is done by the commission, you see that the national governments have less confidence than the commission which surprised me enormously; the national parliaments have less confidence than the European parliament. I do not say that because you are aware yourself but I think it is amazing to see this rejection of, we have a very profound malaise in the advanced economy which is perhaps more, I would say, spread the world over and not only targeting the European endeavour which, it seems to me, has a resilience which is largely superior to what was foreseen in advance. No, that being said we have many, many issues that have been addressed and I would like to have as vivid as possible an exchange of views on these first three interventions. Who wants to take the floor? Please, Madam.

Mari Kiviniemi, Deputy Secretary General of OECD; former Prime Minister of Finland

Thank you for very good introductions. What I would like to ask from Jeffry when you very strongly advised that in Europe what is needed is massive debt restructuring. Could you please elaborate a little bit more of that into the details; what do you mean, where, in the corporate side also as you mentioned or mostly when it comes to certain European countries? However, actually as Daniel also mentioned that the problem is not only a problem to certain Southern Euro countries but also to many other Europe countries too. Then, Mr Aso when it comes to Japan, so one of the good ideas of your Prime Minister is to raise the increase the labour participation of women. Therefore, womenomics is part of Abenomics and that rule is needed and also it will lead to a much bigger GDP growth in your country, I mean, you can use all the potential you have. You have very well educated women in your country but because of the working culture in Japan it has been, before now almost impossible to increase the amount of women in the labour market and also because of lack of certain services too. Therefore, how do you see this dimension to proceeding?

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed. You take note of the questions of course and you will respond after. Other remarks, questions, observations please. Michael?

H.S.H. Prince Michael of Liechtenstein, founder and Chairman of Geopolitical Information Service AG

What I have, and I think Mr Dăianu has touched on it, I think one of the big problems here in Europe is that the economy, the real economy, manufacturing services, does not really get out of the ground. That is not, I think a financial or a monetary reason but I think it is reasons that we have not very competitive labour markets, not competitive enough product markets and we have very high governmental overheads. I have the impression that some of the monetary measures are a very sort of, businessman approach and the governments do not really to have to attack the real reforms in the economy.

Jean-Claude Trichet, former President of the ECB

Thank you for this remark. Other interventions? Therefore, let me add a little bit to the questions which were asked again to Jeff, what exactly and I will join totally with what you said, Madam, what exactly you mean when you say 'debt restructuring'? Do you mean that we should do like Latin America, the comparison was made, but in Latin America, you had first the default of all countries but in my memory, Columbia, but all other countries were defaulting. Then long years of pain which was associated with default which was quite traumatic and then after that you had on the market, on the secondary market if I may, massive depreciation of the various credits that the rest of the world had on Latin America and then you had the Brady plan. Are you suggesting that the Europeans should have defaulted? Would you have arrested the chain of default? I say that because we tried to do with the full support of the entire international community, exactly the contrary. To limit the default to Greece and only Greece and to reconstruct the credit worthiness of all the countries. Therefore, if it is not again the sovereign risk that you are addressing then it should be the private sector. There again, where do you see that we should speed up the so called restructuring or the taking into account of the real situation of the number of firms? It seems to me that that is supposed to be done spontaneously by the market economy and of course a lot of losses are taken by many, many banks. However, I take your suggestion that at least in this domain, things are not going sufficiently or rapidly and I think we have to reflect on that. However, there is another element and perhaps you could comment on that as well as Daniel if he wishes. In Europe the financing of the economy is done by the banks in the proportion, at least before the crisis, of 80% in the US banks only represent 20% of the financing of the US economy, markets are of course in the reverse proportion. Therefore, in Europe it is true probably that the main problem that we have is that the banks themselves have a position of weakness and they are the key position as regards the financing of the European economy and this is a particular issue which is very important. In that respect perhaps banking union is something which is an important part. Only to add to the question which was asked.

Please, Sir, you have the floor.

Yusuf Irbec, Member of Parliament, Republic of Turkey

Thank you very much. Irbec, Yusuf here from Turkey, from the Turkish parliament. If we speak from the default of the countries in Latin America possibilities and, we should distinguish I think from the flow and stock economy. The economies are not to a great extent under control and therefore the extent of corruption is differing from country to country because of the stock economy management in many countries. How are you evaluating this point because the corruption between the default of some countries in Latin America or it could be in Europe because the centralisation is a trend now on the one side, on the other efficiency is another problem? What is the effect of the corruption trend of that development? Thank you very much

Jean-Claude Trichet, former President of the ECB

You mean corruption...

**Yusuf Irbec, Member of Parliament, Republic of Turkey**

In the countries, in the countries because...

Jean-Claude Trichet, former President of the ECB

In Europe?

Yusuf Irbec, Member of Parliament, Republic of Turkey

No, no in general because the problem, in flow economies it is easier to control, in stock economies it is impossible to control the degree of corruption. Which types of measures could be foreseen in order to combat that trend? Thank you.

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed. Other questions? Other remarks?

Another issue has been addressed by Daniel: the governance of Europe and the governance of the Euro area. I would like Daniel to comment on what I consider the new governance which has been created as lessons to be drawn from the crisis. For instance the MIP, the macro economic imbalance procedure, that has been introduced, the reinforcing of the SGP, the banking union of course that are three new dimensions or reinforced dimensions of European governance to the extent that you mentioned the fact that, for you it was totally insufficient. Then which kind of new concept of fiscal union would you practically call for in the Euro area, do you have a particular concept in mind?

Thank you very much. Well I do not see many other questions are you really sure because it would be the last window of opportunity to ask a fantastic question. No? If it is not the case then I will give the floor to the speakers to react on what they have heard. You did not have too much questions, Aso san on your own exposition so I take it that the group considers that the Abenomics will be a full success. However, would you comment a little bit on the structure of reforms, the third arrow? Do you consider that it is really delivered or are you confident that it will be delivered after the elections? I give you the floor if you wish, then to Daniel and then to Jeff. Please.

Yutaka Aso, President, Aso Group

Yes, this is a hope and we have not seen any omen in terms of the figures but I do feel, as a matter of fact, I know the result of October and November is coming soon and the third quarter of the fiscal year will be announced early February, I do not feel that will be bad. The biggest sort of the background of my positive thinking as a CEO, they are very confident to use their cash and M&A even inside the contracting market economy, they are going abroad. However, the weakness of the Japanese is their communication skills and that kind of handling in English and others. Even big companies such as the Takeda Pharmaceuticals and Suntory, they replace their CEO not COO, CEOs who are international because owners think that Japan is a boiling down market but Asian and new challenging markets offer great opportunities with the product reputation and image. Therefore, these kinds of deals, M&As, are announced constantly now. A very spiritual way of explanation but I do feel that kind of background of existing cash and trust from Asia and Korea towards Japan; we have already many issues around the Korea and Japan alliance. Because Korea is dynamic and quick and good at communication. We need time to make a decision but on the other hand, we have the trust and reputation, so let us go together to the third country. That combination to the third country together is working well.

**Jean-Claude Trichet, former President of the ECB**

Thank you very much indeed. What you say is really very important and I have to say it is new for me this de facto alliance in the industry between Korea and Japan.

Yutaka Aso, President, Aso Group

China is a similar case.

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed. Daniel you have the floor.

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

When it comes to financial markets and the perception as to what an economy can deliver, in the end it is the overall debt of a country that matters. One of the big revelations of the current financial crisis, of the euroarea crisis, is that even mature economies can face big balance of payments difficulties owing to public and private debt. At the end of the day, what matters is if an economy can embark on a path of economic growth aiming at servicing its debt. If there is no economic growth there is no way to service the debt without curtailing domestic demand drastically. And this policy choice can easily backfire by triggering vicious circles. Consequently, a default may be implacable unless there is external support. There is a fracture in the Eurozone: there are economies which are clearly competitive, which have better business models, which Daniel Gross calls, though I do not like this term, 'the Teutonic cluster'; and there is a southern cluster, with lower economic performance and very much in pain currently. The bottom line is: can we foster economic growth in the Eurozone not in a divisive way?

Secondly, you are right about manufacturing, that there should be structural reforms. There is a sort of sclerosis in this respect. By the way, people have been talking about Euro sclerosis, as a wider encompassing concept, for a long time. There is also a crisis of the welfare state and there is too little spent for R&D, which should compel policy-makers to examine both national budgets and the EU budget. However, having said that, there is another reality; that if aggregate demand is much subdued because of misguided policies, it is very hard to undertake structural reforms. It is easier to undertake such reforms when there is a sense of optimism, when there are prospects for economic recovery. People are losing patience because governments do not deliver, and this is the biggest threat for democratic politics in Europe.

Now, when it comes to funding economic activity it is correct to decry the overdependence on banks. Europe relies too little on capital markets. Capital markets should be developed, but this is easy to say, it is very hard to do. Having said that, I take the view that capital markets have to be well regulated and supervised too, because what is happening now is that systemic risks are being transferred, migrating onto markets which are under-regulated and under-supervised – as capital markets are. In due time, in my view, the regulators and supervisors of capital markets, ESMA in Europe and IOSCO as a world body, are going to get the same concerns as the people who sit on the board of ESRB in Frankfurt, of the FSB, and central bankers in general.

Regarding the new governance structure of the EU, of the euroarea, it is fair not to have onesided adjustment of external imbalances. This is especially valid for the single currency area, where the policy space, the leeway to use correction tools, is pretty restricted. In the global economy, dealing with large imbalances is a matter for discussion and a matter for policy coordination. I see the international policy regime as being deeply flawed, and I think Jeff has been very diplomatic in this regard, for the way huge financial flows are moving around the world is quite destabilising. Of course, they are attracted by arbitrage, profit seeking, but I share Joseph Stiglitz's view that the current system



operates like an inbuilt destabiliser for the world economy. Therefore, imbalances have to be taken care of in a symmetric way. In the EU, the banking union has to be completed and this includes a strong financial backstop and a collective insurance scheme. The fiscal capacity, which I have mentioned already, makes common sense, it is badly needed. By the way, the MacDougall report of 1977, said that a monetary union should have a budget of 6-7% of the cumulated GDP of the member states. Therefore, there are things that should be done, but there is also politics, there are constitutional matters in Germany, etc.

Lastly, it is trust. Trust is in short supply in Europe; governments do not trust each other, and without trust what do we have? Only bickering.

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed. Jeff.

Jeffrey Frieden, Professor of government, Harvard University

There have been a lot of questions raised and I guess I anticipated that, wading into the difficult politics of the Eurozone crisis. A couple of observations: one, I think the point that was made about the potential negative effects of short term policies is a very important one and it is one that we cannot get away from. In the current situation, as is almost always the case especially in times of crisis, measures that are necessary and desirable in the short run may have undesirable long term implications. That is just the reality that we deal with. We would like of course not to have that reality. The example you gave is that the looser monetary policy is, the more it allows policy makers and society to postpone necessary structural reforms. I think that is undoubtedly true, just as it is also true that anything that smacks of debt relief or financial relief such as re capitalising banks, necessary as they may be to save economies from collapse, creates moral hazard. There have been econometric studies along the lines of what Mr Trichet mentioned, indicating that if there had not been the coordinated intervention of monetary authorities, given the run on markets in September=October of 2008, the crisis would have been much more severe than the Great Depression of the 1930s. So, yes it is true that these short term measures can have undesirable long term effects, but that is life and we just have to figure out how both to get the most out of the short term measures that we need to undertake and, to the extent possible, to mitigate their negative long term effects. However, it is a serious problem and a very important one.

Along similar lines, I certainly did not mean to imply and I do not think I said, that it is all on the supply side or all on the demand side. I think there are very serious supply-side problems in the financial system and very serious demand-side problems in the private sector, both corporate and household, and both need attention. So, I just wanted to make that clear.

On the issue of debt restructuring, I think people are right to ask questions about it, it is not a simple matter. Restructuring in many previous cases, as Mr Trichet pointed out, was made possible, or at least easier, due to the gradual write-downs of the existing debt. That was the case in the US: the Brady plan was palatable to financial institutions by 1989 because many of the debts had been written down, and there had been very substantial regulatory forbearance. Therefore, the banks could take the hit that the Brady plan implied. However, it was also the case that whether on the part of the private sector, the financial sector, the US government, or the Latin American governments, the perception had become generalised that continuing in the past way was not feasible. It was not in anyone's interest to continue to pretend that the debts would be serviced in the amounts that they had been written for. I think that comes close to being where Europe stands today. I come back to drawing the comparison with the private sector, where we have chapter 11 and restructuring. If the creditors and the debtors understand that you cannot move forward, you find a way to restructure the debt so that both the creditors and the debtors are better off. That is the point that I am trying to make. I think that there is a Pareto improvement available that would make both the creditors and the debtors better off.



Now, questions were asked about specifics, I certainly do not have time nor do I have the information available to go into detail about specifics, but I will point out there are enormous differences among countries. Ireland is not Greece, and the Irish debt problem has nothing to do with the Greek debt problem. These are completely separate sets of issues, except for the fact that they are both in the Eurozone and both have substantial debts. So, each case is a case. I will say that there have been some attempts in specific countries to deal with the problem. To my knowledge, the Portuguese are the only ones who have attempted a corporate debt restructuring, and I am not aware of all the details of how that has gone. It does strike me as anomalous that there have been no attempts at corporate debt restructuring on the part of any of the other principal debtors that I know of, but my knowledge is certainly limited. There is no need for a default, but I think that there is a need for an understanding that continued stagnation is not in the interests of anyone on either side of the teller's window. That this is not a sustainable situation.

Finally on the macro economic imbalances, since they have been mentioned. I do think this is an enduring problem: I noticed in the paper today that China just ran a record surplus in the past month. Just to inflame a few more passions, I'll quote my colleague Larry Summers. He and I were on a panel together a couple of weeks ago about the European situation and he said, talking about the European situation, that the core problem in Europe is what he called German economic theory. German economic theory is that every country in Europe should run surpluses with Germany, and Germany should run surpluses with every country in Europe. There is this enduring problem of macro economic imbalances that I think is at the core of a lot of the issues that have been raised. Along with Ernesto Zedillo, Dani Rodrik and Michael Pettis, I co-authored a Geneva report a couple of years ago, which was extremely unpopular. We knew it would be unpopular and it was, because we focused on macro economic imbalances and said, 'This is an enduring problem and it needs to be addressed'. The almost unanimous view of those in Geneva, dominated by people involved in the Swiss and German economic debates was, 'These imbalances will go away, don't worry about them, it is a natural phenomenon, the German imbalances are already disappearing, the Chinese imbalances are disappearing'. Well, that is not true. It has not been true; it is not true. I think there is an enduring problem associated not only with the global financial markets but also with the underlying differences in national political economies. Some economies are single mindedly oriented toward generating surpluses. This can be a great way for an emerging market to grow, but not every country in the world can run a surplus with every other country in the world. Thus it raises real problems that have to be negotiated about if we are going to avoid recurrences of the kinds of crises that we are still living through.

Sorry for dragging on but there were a lot of issues raised.

Jean-Claude Trichet, former President of the ECB

Not at all, I think we could continue to discuss that. I feel very frustrated myself because I would have been the devil's advocate for Europe and I have a very long series of points I would like to make but perhaps I could introduce that later on because we have to give the floor to the other speakers.

However, let me tell you that European bashing has been constant in any circumstances since the very idea of the creation of the Euro. I have been told the Euro is impossible to make. I have been told, the Euro will evaporate, the Euro area will disappear because in the worst financial crisis ever since World War II, of course, the Euro area which is much too bold an endeavour, cannot hold. Finally, what happened? At least in terms of existential issue for the currency and for the Euro area the currency was constantly higher than the US dollar on the exchange market during the entire crisis. Income present with the entry level which was 1.17 and, I have to say I am not particularly content with that because it might be a problem but for a currency which was supposed to evaporate it is a little bit bizarre. The Euro area which was under threat obviously and still is in certain respects was made of 15 countries and the moment of the collapse of Lehman Brothers, the 15 stayed and their democracies have decided to maintain their presence in the Euro area, including Greece. The 15 are still there, three new countries entered after Lehman Brothers and a new country will enter next January so that will be 19 next January, where we have 15 at the time of Lehman Brothers. I say that not to say that success is obvious but to say that at least the underlying strength of the endeavour, the underlying historical endeavour is quite remarkable because after all it was a big stress test. Now, I agree with you and Larry, I have also a lot of discussion with Larry and others, that the real success is jobs and growth



and it is clear that in this domain we have to deliver and we are far from delivering. However, a last remark, the big difference between the Euro area and the US seems to me according to the IMF, for this year, next year is probably 2% growth. We are miserably at something like 1% in '15 when the US might be at 3% in '15, we will see are all reflecting on what exactly is the growth potential of the advanced economy now.

Now, we have not got the Shell gas, and I am speaking under your control Jeff, a lot of my US friends are telling me might represent 0.5% of core. It is not negligible. This is a game changer in some respects. You have demographics because you have to turn that in growth per capita and then of course Japan would have a, gifted with a growth per capita largely superior to the apparent growth and Europe too, the difference might be 0.8% so what remains is 0.7% of difference for the two years that are coming. What to say of that? Of course the Europeans have their own dramatic, specific sovereign risk crisis. Even if I have to say the debt overhang of the advanced economy exists, in Japan it exists 240% of the GDP? It also high in the US or in the UK. However, I will also draw your attention to the fact that despite this adjustment, and the US went through a big adjustment, the current account deficit of the US is still 2.5% of the GDP if I am not misled. The current account surplus of Europe is 2.5. I would prefer that we would both be at zero, to be clear because it seems to me that we cannot run permanently, I would say, big deficit or big surpluses. However, I think that this which I explain crucially by the European crisis of the sovereign risk because it is abnormal for us to have plus 2.5, we were at zero approximately before. So, but if you introduce 5% of the GDP difference between them then you see that the macro economic 'reglage' is responsible for a large part of these differences, growth and it is not because the Europeans are dramatically hampered by their stupidity. It is more complex than that, but I agree on the fact that we would be judged on our capacity to deliver jobs, I fully agree.

Jeffrey Frieden, Professor of government, Harvard University

I certainly do not mean to come across as a Euro basher, I have been following and involved in the European project for decades and I am a big supporter of European integration. I would love to see the problems resolved. Nor do I think that the US is doing so wonderfully well. Median wages in the US are 5% below where they were in 2009 and we face many of the same social and political problems that Europe faces. I do think that, from the standpoint of the global economy, the difficulties in Europe are very serious and that is all I really mean to say. Not by any means to bash the Eurozone or Europe or to downplay the extraordinary importance of the measures that were taken by the ECB in the aftermath of the crisis.

Jean-Claude Trichet, former President of the ECB

No, no, I certainly did not miss that and I have known you for a sufficient period of time to know.

Jun Kwang-Woo, former Chairman of Korean Financial Services Commission (FSC)

Mr Chairman, may I intervene before we move on to the next round?

Jean-Claude Trichet, former President of the ECB

You have the floor.

Jun Kwang-Woo, former Chairman of Korean Financial Services Commission (FSC)



First of all, organisers should be congratulated for having this prestigious conference in a fantastic facility in Seoul, which is much better venue than the ones you see in Davos. And so, I may say we are proud of having this conference, not to mention distinguished speakers joining us today.

First a few comments on what has been said and then I would like to share with you my perspective on global economic prospects. Aso san mentioned some virtues of having a collaborative approach in the Northeast Asia, especially between Japan and Korea. I think it's a great idea. An interesting example may be the Soft Bank chairman Masayoshi Son who made a fortune out of the recent Alibaba IPO on the NYSE. When I met him a few years back in Seoul, I was very impressed with his passionate entrepreneurship and innovative mind. Mr Son's case is quite interesting because his background and business represent three countries in the Northeast Asia; he is a third generation Korean Japanese and has active business operation in China. What could be a better combination than that? I think there are ample investment opportunities to be explored collaboratively within the Asia region and around the world. As a related example, I may add that there is an on-going relationship in the area of institutional portfolio management. We already have active partnership between Korea's NPS, which is the world's third largest public pension fund with almost USD 500 billion dollars and Japan's GPIF, the world's largest public fund of over USD 1 trillion. China also has similar institutions such as NSSF and we often collaborate on how best we can pursue our common interest.

Mr Trichet and others have spoken about demographics. The way I see it especially from the vantage point of Korea which is witnessing the very rapid aging, I think it is perhaps the most serious challenge to the future of our country and, for that matter for many other countries as well. Why do we have such a low, falling total factor productivity? I think one of the contributing factors may be demographic change. I have not seen very elaborate economic research on this causality, but I suspect the aging population might be behind declining total factor productivity that derives from innovation and creativity. In general older people tend to have a low risk tolerance and not aggressively engage in venture type investment. So, the result is: saving more, spend less and prefer safer assets. The overall environment and investment climate is being greatly affected by the demographic changes that we are experiencing. Therefore, when we discuss secular stagnation, we must pay greater attention to the demographic factor. We also need to think hard how effectively to bring older people with higher savings to spend more. That is an important angle that we need to pay more attention to.

Now, let me touch upon another couple of points on macroeconomic issues that have already been mentioned by former speakers. I think the world economy is heading into a period of increasing divergence and differentiation across countries. What I say may be highlighted by the remarkable evolution of so-called BRICs. Up until a few years ago, they are the dominant rising power house. Now if you look at BRICs today the parts are moving in separate directions. By and large, Brazil is in bad shape, Russia is falling apart, with its market capitalisation has literally halved. India is getting better, with some improving investor sentiment, especially since Prime Minister Modi came on board. On the contrary, China is slowing. Although we did not discuss much about China today, it is such an important factor for the future path of the global economy. I hope we will see a soft landing but there are legitimate concerns about a hard landing scenario which is very detrimental to the future growth around the world. Therefore, what I am saying is that at one point BRICs looked like a strong homogenous group but now, a very much like a heterogeneous set, implying that you will see more and more differentiation across country performance.

Now, I also see the next year as a period of changing tides. We all know that the US is the only one that will taper QE and move on to contracting monetary expansion but others are not. BOJ, ECB, even the Peoples Bank of China and most other are in need of continuing to pump money to the system. Therefore, on the one hand, there is a cold current, and on the other hand, there is a warm current. I say this in part because my previous job was to manage big funds, so I am trying to generate some investment implications. In general, when we have changing or conflicting tides of economic situation, we have more volatility and uncertainty because market confusion and changing direction of capital flow as well. With respect to investment strategy and policy choice, it may be useful to note that when a cold current meets a warm current we may have more fish. That tends to become a fertile breeding ground. From my experience in recent years, I say that we have extended our investment horizon to alternatives because when we have an environment where unconventional policy is in pursuit then investment managers should also look at unconventional investment choices. Along this line of expanding investment scope, I am happy to let you know that Korea's NPS has recently made an investment in Poland for the first time. It is a big project, a real estate investment



package worth close to USD 1 billion. In the past, Korea's NPS has focused more on advanced economies, including large property investments in Europe, notably the UK, Germany and France. What I am saying here is that the changing economic currents or tides clearly present a challenge for the policy makers and the international community, but at the same time they could create new opportunities for cross-border investment.

With that I will stop my intervention. This is my first participation in this conference and I would like to appreciate great insights of our distinguished speakers. Thank you.

Jean-Claude Trichet, former President of the ECB

Thank you very much indeed we learned a lot from you and when I referred to Aso-san saying that the Korean have a capacity to communicate, which is fantastic, I think it could be the compliment we could give you. Thank you very much for what you have said.

What I would suggest now is to give the floor to the next speaker and perhaps, Marek, if you wish, you could intervene immediately afterwards so that we will have the three last interventions and we could discuss all the complex matters that have arisen there was this remark of Mr Kwang-Woo, that when central bankers engage in non conventional measures, boom, they stand for investors also in non conventional ways [inaudible].

Please, you have the floor.