DANIEL DAIANU

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In spite of the efforts to maintain what is called the liberal international order, deep currents are working against it. I could provide a rationale why this is happening, and I guess, what one should try to do is to undertake damage control. In Europe, and also in other parts of the world, ever more worries are linked to job losses and rising uncertainty, be it related to new technologies or global competition In addition, there is a worry understood the need for safety including physical [security]; people are afraid about what could happen to them on a daily bais. And in Europe, citizens do not ask EU institutions to protect themo, the pressure is on national governments and this is going to continue for years to come. Analytically, one can imagine a price line with a trade-off between safety and openness. Both are public goods, but during hard times, people value, presumably, safety more. And vice-versa, during god times, openness is valued more highly in relative terms. Here I think lies the origin of the inward-looking syndrome which we see in Europe, in the US, etc under the guise of closing borders, governments being more intrusive in people's lives, rising protectionism, etc. To "America first"' slogan across the Atlantic corresponds Juncker's EU not to be seen as a "'naïve free trader". Another issue is that when markets freeze, liquidity is never sufficient. When a big shock hits the global system, liquidity can easily fade away like water in the sand; a liquidity trap can operate very, very intensely. ETFs have been mentioned and I would extrapolate and refer to capital markets in general. When it came to banks, the lender of last resort function was performed by central banks, so I am asking myself: who is going to perform it in capital markets should the need arise? We have a precedent with the Long-Term Capital Management episode of about two decades ago. At that time the big guys on Wall Street were induced by the Fed to do something, because if nothing had been done the system might have collapsed. In my view, this could happen again. Non-bank actors increasingly provide banking services and create major systemic risks..

I wish to raise another issue that begs answers. Is the financial system simpler now than it used to be? If, instead, it is more complicated and hard to manage, this is the route to bigger troubles. And I would argue that the evolving system is not simpler. Financial innovation goes on and toxic products are put on the market and used, in spite of an allegedly more effective regulation and supervision system. The irony is that there is a growing pressure to deregulate again. I find it quite striking. And this pressure one can see not only in the United States, with the new Administration, I very much hope that Jamie Dimon and other top bankers will resist it for the sake of a more robust financial system.

Another big question is how much rot there still is in the balance sheets of banks? One indication in this respect is that not a few governments and central banks in Europe are reluctant to undertake the bailing-in procedure Arguably, an ongoing crisis management process is still underway in Europe, despite of a cyclical economic recovery.

And not least, there is the question: for whom does the system work? One could say, look, we have reformed finance and made it function better, for the benefit of the entire society. And if it does not work for the benefit of all citizens, even that could be acceptable if another big crisis hardly looms on the horizon. For, one should not expect a system to be perfect. However, if we are going to bump from one episode of big crisis to anotherthings have to be judged differently, however much we deem to be inevitable and part and parcel of the way capitalism works. The question is whether the complexion of finance and the nature of regulation and supervision influence the magnitude of a crisis, how many people are impacted severely, etc. If people think that the system is not functioning for the benefit of most of them then what do we get? Enormous social strain which comes out of rising income inequality and an increasing number of losers. Thence comes a growing pressure on the political system and fringe, extremist parties come to the fore.

This is the crux of the matter, which is not related primarily to ETFs and non-banking actors that provide banking services. I believe that one has to dig more profoundly in order to get adequate answers. Some of the people who used to be at the very top of decison-making, like Mervyn King, have raised fundamental questions about not only the architecture, but also the very functioning of banking, the fractional reserves logic, etc. God forbid, if a new episode of big crisis hits us while our economies are not soundly recovered. What is going to happen, nationalise the whole banking sector? The big question is therefore: what next, after a crisis erupts? Can we intervene? What are the tools? I think that these are questions we need to address in a straightforward manner.

John LIPSKY

Now, in operational terms, does this mean that the die is cast, and we are just along for the ride? Does it mean that central banks should be quickly withdrawing their current support for financial markets?

Daniel DAIANU

In one sense, the Bank of International Settlements (BIS) seems to underestimate the power and effectiveness of macroprudential tools. We did have capital controls decades ago. They were effective for several decades after the end of ww2. Afterwards, central banks and regulators embraced a paradigm that extolled the virtues of completely free financial markets. That philosophy was espoused by the IMF, the IFIs, and was imposed around the world. For instance, Asian economies were collapsing while Michel Camdessus, the then MD of the IMF, was suggesting to their leaders, in 1997-1998, to continue to open their financial markets. We should not be blindfolded and we should ask the right questions, because otherwise we are going to be overwhelmed by events. I think that the BIS is right to highlights side-effects of QEs, but the BIS, in my view, needs to have a more nuanced stance regarding capital controls. We should resuscitate the Bretton Woods arrangement's logic. We need the EU to work with Americans, the Japanese and the Chinese to this end. The Bretton Woods arrangements were policy coordination in action, with a clear logic, but not a few seem to resist it now. You know the mantra, and I heard it at various debates, that there is no way to have policy coordination under current circumstances. If one starts with this working assumption then it turns into a self-fulfilling prophecy.