DEBATE

Frans van DAELE

I do not have many solutions. I just want to refer to Barbara Tuchman's *March of Folly*, which starts as a first chapter with the stupidity of the government and the King of Troy letting in the horse. He should have known that. I was a bit involved in the Euro crisis, and a lot of what we did had to do with governance, governance inside the European Union, that is. For instance, we transferred a lot of powers from the capitals to Brussels as far as fiscal discipline is concerned. We transferred a lot of powers to the national central bank as far as prudential supervision was concerned.

I thought about that when Professor Frieden was referring to new socio-political models. I was wondering whether we were thinking enough about something which may seem too far-fetched, given the fact that multilateralism is going down a slippery slope anyway. We should think a bit more about what instruments we can build and could build over time. This is to try and make sure that the policies one country is following are not harming and hurting other countries too much.

That is the basic line we have inside the European Union. The economic policy of an individual country is considered to be a matter of common interest. You cannot do it and even if you do, it turns against you, as was the case in Ireland. I would like to know, Professor Frieden, whether there is any thinking on the governance side, regarding all the crises and catastrophes which are looming over us.

Jim HOAGLAND

Jean-Claude, you started by saying that you were concerned about the world economy now and the prospect of a new crisis. However, you did not explain why. I wonder if you could do that, but let me ask a very uninformed American question. This has to do with your assessment that a key to resolving some of the current European problems, the Euro problems, lies in Germany and inflation. Could you explain that and tell us why they will not do it?

Jean-Claude TRICHET

Part of your question is echoing my own interrogation on Japan and Germany, and perhaps the Netherlands. These are countries where the unions in particular and the labour force are so keen, and rightly so, to reach full employment and not take any risks on full employment. This means that ultimately, you will not have what you would have expected at a certain level of heating or overheating, namely the real demand coming from the labour force.

In a way, this is a phenomenon that we are observing in all countries, but it is particularly acute, it seems to me, in certain cultures. These are certain cultures which are at the level of full employment and where everybody in the social fabric would like very much to stay there and does not want to take any risks. I must confess myself, I made a mistake on the German fabric. I thought that at a certain level of full employment, you would have this kind of request for augmentations in wages and salaries. That would augment unit labour costs and that would enable Germany to be back at a more normal level of inflation, taking into account a current account surplus of 8% of GDP.

It would enable them to go back to their traditional yearly inflation during the 40 years before the euro, which is significantly higher than what we are observing since we have the euro. My own provisional response would be that we are in a situation first where unions in general and the labour force considers that the wage expenses were extraordinarily effective and efficient in getting full employment. Before changing their own behaviour, they would reflect a lot, and they are still reflecting in some respects.

A second explanation, which is also new, and I have been reflecting on that for two years, is that perhaps we were under-assessing labour mobility inside the Euro area. We observed many more Spanish, Portuguese and Italians going into Germany than we would have expected. You know that the main criticism of the Euro area at the very beginning was, you will not have this labour mobility which exists in the US and you will be hampered by that.

The paradox is that we did not have much labour mobility at the start, and in the crisis, because of the crisis, we are observing a high level of labour mobility. I was struck by the fact that it looks like 300 000 workers coming from the Euro area came into Germany in the year '15. That was not expected, and it is such a big influx of new labour. You can understand it weakens considerably the demand of the German citizens, who are themselves working in the labour force. That is for your second question. Your first question was different.

Why am I worrying? As you can see, it is a sentiment which is quite generalised. I will concentrate on only three elements. I say three so as not to embark on eight or nine or whatever, because you can go very far. First, I am struck by the fact that we still have augmentation of financial leverage at the global level. There are different methodologies, different computations. I myself chaired the G30 and I am still honorary chairman of the G30.

We produced a report which was clearly signalling something though it was 2-3 years ago. This was that the pace of additional outstanding debt, public and private, at a global level, as a percentage of global GDP, had continued after the crisis at more or less the same pace as before the crisis. It might not be exactly the same now. The IMF has worked a lot on that and has produced figures that are different from the figures we had. Nevertheless, the idea that it continued to go on at the global level is still there.

Another element which is a little bit intriguing is that the epicentre of the crisis was in the advanced economies, and the advanced economies have deleveraged a little bit. Some have done this substantially and others less substantially in the private sector. However, apart from a very few cases, they continue to augment leverage in the public sector, in the public finance sector. All taken into account, there is the pace of additional debt outstanding, public and private, as a percentage of GDP. This was at 90% before the crisis on the augmentation of debt outstanding and is now at only 50%. You could say that if the pace is the same, it is a big diminution by a factor of two of their contribution to global financial leverage.

If you take the emerging economies and all the other economies, then they had a contribution of 10% and it is now 50%, so it has been multiplied by five. China is a case in point, because we see a very big augmentation of debt outstanding. This is particularly, I have to say, in the private sector, or so-called private sector, with an explosion of corporate bonds in particular. However, taking all that into account, this signals something which is very unhealthy. This was that we did not draw lessons from the fact that one of the major dimensions of the crisis was over-leveraging. I would fully echo what has been said on Fisher and also on Minsky. We have elements there that are worrying.

The second element is asset inflation, which we have observed in a number of countries, and particularly in the United States of America. A correction will happen and Jean-Claude is particularly worried about that. Many very good American economists are also particularly worrying, I have to say. Martin Feldstein in particular regularly says something will happen. It never happens at a time that you can predict. When you continue to make money out of the increase of the assets that you have on the share and stock markets, you appear a stupid guy if you disinvest. You give good advice to your clients and at this time, the advice will be good. That is what we always observed.

There is a last point, which is not to be neglected. In the cycle, we are 10 years after the start of the recovery and we had counter-cyclical measures that were taken in a number of countries, particularly in the United States of America. This is not good in terms of smoothing the cycle. It amplifies the possible cycle, particularly when the time comes for the recession.

When the recession comes, as has been said, you have very meagre remunerations as regards the monetary policy. I have to say this particularly in Japan and in Europe, but also in the US in many respects. They say, and I am speaking under the control of eminent economists, that they would need a 5% decrease in interest rates to have something which would be sufficient to combat the recession. They are not there, and it is very unlikely that they would be there when the time comes.

The fiscal element in countering a crisis is not there either. Only a very few countries in the world can say, 'We have room for manoeuvre'. You can see that all these elements, and I am only sticking to those three, are not putting me in a situation of being very optimistic about this. Thank you very much for your question. The speakers can intervene at any time if they think it is appropriate.

Renaud GIRARD

Should I understand from this session that there was too much quantitative easing from the Fed and from the European Central Bank, which is a kind of quantitative easing? That is my first question, and my second question is this. Can we consider that for this crisis that you are all more or less predicting for us, quantitative easing would not be an efficient tool?

Jean-Claude GRUFFAT

I am sorry I missed the beginning of the workshop, so I may have missed some of the things. Coming from my perspective, I am a banker and I have been a banker for many years. I am still in financial services and I work for European banks and American banks. I have lived through many financial crises, including the last financial crisis, and there was something that struck me. There was a lot of leverage in financial institutions at the beginning. The case of Lehman's is obvious. There was a level of 50 or 40-50.

Now, things have improved a lot, particularly for American banks. It is fair to say that American banks are probably better capitalised than European banks on average. Having said that, do you not think that we are in a situation where regulation has been implemented. Nevertheless, Dodd-Frank has some shortcomings and weaknesses. There has been an attempt to reform, and my sense would be this, because you are looking for solutions. Do you not think that if we want to reduce the burden of some of the regulations, we have to increase the capitalisation of banks?

Recently, I had the opportunity of listening to Alan Greenspan, who was speaking to the Economic Club in New York. Alan Greenspan was making the case that we probably need to be in a safe situation. We are talking of regulated institutions, but also, the comment that has been made about shadow banking is very pertinent and absolutely adequate. Do you not think there is the leverage, which is now probably this? The capitalisation of banks is about 10% now. I would say 10, 11, or 12% depending on the size. It can be up to 12%. Do you not think that we can request 15 and perhaps 20%, to be in a safer environment, to be able to deal with all the problems that will come up at some point?

Jean-Claude TRICHET

In Europe, we are at approximately 14%, if I take the significant financial institutions, and in the US, it is higher. In order of intervention, can I ask each speaker whether he has any comment to make or any response to bring to the questions we have?

QIAO Yide

I will answer the question regarding the quantitative easing. I still think that QE created lots of problems, particularly as someone claimed. The QE took care of Wall Street first, then took care of Main Street later. That means we are using a quote that other people say is classical logic, but at least QE makes sense in saving the whole financial crisis from total collapse. In that sense, for example, in China, we did not see a defined stimulus package in 2009 as QE. Actually, the total money China put in took up 12% of the GDP of China. This is much more than the US, because the US money totalled 9% of the US GDP. However, in some way, it is working. Although they create lots of negative problems, I do not think there is another better way to deal with this kind of systematic collapse.

Jean-Claude TRICHET

Can I turn to Jean-Claude now? How would you respond?

Jean-Claude MEYER

Maybe I can comment on Renaud's question about quantitative easing. You would do so better than me. However, it has been a very good thing. It has been a miracle that has been invented with this quantitative easing, both in the United States and in Europe. The problem is, when you stop it, it is a kind of drug. You have a drug and then you stop your opium and then you feel very bad. That is a question we raise which we can raise today, when we stop it, especially when things are not very good.

We must not smoke opium today. Things are not good today. There is a lack of trust and there is anxiety. As a matter of fact, I wrote my paper at the end of September or the beginning of October and drafted it. 10 days after that, markets plummeted and are 10% less. It is not tomorrow, because markets are closed, but regarding Monday, I do not know. We are in a new world now. We are ending in a way that I must say is quite good from a moral viewpoint. It has been obscene to see the stock market is going up every day by 1%. The people who have 1% are extremely rich and the rest of the population, which has no stocks in this market, are poorer and poorer.

Jeffry FRIEDEN

There is a lot to comment on, and I will try to focus on some of the more political or political economy issues. I have to say something on the quantitative easing. To me, there is a crucial lesson I take away. From the economic standpoint, I agree with what has been said. The crucial point I would take away is that this was a result of the unwillingness or inability of governments to engage in sufficient fiscal stimulus. The fact that the relatively independent central banks carried all the water pretty much for the recovery indicates the very weak political bases that we have for confronting the problems that arise. We should have had a much bigger stimulus in the US and European policy was pro-cyclical rather than counter-cyclical. That tells us something. It is the beginnings of the understanding of the political failures that we have seen.

I want to address particularly the point about global governance, which after all is the dilemma or the slogan of the meeting. There is a very clear normative view, which is very straightforward. Just as when financial markets went from local to national, there are public goods associated with financial markets. This may be lender of last resort facilities. Financial stability in itself is a public good. We got national financial institutions that provided the public good of financial stability.

We have global financial markets today. There is clearly a demand for something resembling global public goods provision in the international financial system. Some could argue that to some extent, it has been provided by cooperation at the level of the G7 or the G20. Some could argue that it has been provided, some aspects of lender of last resort facilities have been provided by the IMF and augmented by national governments. There is a clear normative argument for something that we would call global governance, in the financial system as elsewhere. However, the financial system is particularly striking, because the theoretical underpinnings of understanding why there is a need for public goods provision in finance are very strong.

Also, I would say that to some extent, it has gone further in finance than anywhere else. You could have asked me 25 years ago would there be this level of cooperation at the regulatory level, with Basel, or with the fund, with bail-outs, with programmes, monetary policy cooperation and all of this. I would probably have said no way. There has been more progress made.

The problem is that for the continued provision of those global public goods or even something resembling global public goods, there has to be domestic political support. People are not going to support government policies that are aimed at some abstract, ethereal notion of global financial stability. This is first if they do not believe it is going to help them and second, if they believe that it is going to hurt them, which they do.

As an example, some of you may remember that there was massive opposition in the US, not to the bank bail-outs, but the sovereign debt bail-outs of the 1990s. This was such that there was a whole series of laws passed which seriously hamstrung the ability of the Fed and the Treasury to engage in those packages. The sponsor of both significant legislations was Bernie Sanders, and he has continued to make the argument that American involvement in these packages is against the interests of the American people. Donald Trump doesn’t have that sophistication, but if he did, and his people do, they will make the same argument.

This is directly relevant, actually, to Jim’s point, or to the question Jim asked about Germany. The point is not that countries malignantly decide to impose costs on other countries. It is that they are concerned, legitimately, with their own political, economic, and social wellbeing. he Germans did not continue to run massive surpluses at a time when they should have been spending them down and running deficits.

The old line is that the problem of Europe in the crisis was German economic thinking. This said that every country in Europe should run surpluses with Germany and Germany should run surpluses with every country in Europe. This is unsustainable, but it did not come from some bloody mindedness on the part of the German people. It came as Jean-Claude was saying. There are arguments in the literature about why. Some people think that it is an unholy alliance of exporters and the elderly in Germany, insisting on low wages and low inflation, but you could talk about national cultures as well.

The point is that German economic policy is driven by the demands of the German people. You may not be able to get this in a region as integrated as Europe, where Germans support European integration. If you cannot get a commitment to do something that is essential for the prosperity of other members of the Eurozone out of the German people, then there is an underlying problem. What is the domestic political support for that kind of global cooperation or global governance going to look like. It did not look good in the crisis. It does not look good now. We face more difficulties and we now have political movements that are in some cases very explicitly opposed to anything that looks like global cooperation.

I want to mention one more thing, because people have been talking about leverage. Leverage is an important issue. To me, it is not leverage per se, but where it is, who it will harm and how it will be addressed. People talk about the emerging markets. There is a crucial fact about leverage in the emerging markets that has gotten far too little attention. The big story of the last 15 years in the emerging markets is that for the first time in modern history, sovereigns can borrow in their own currency.

There is the old original sin argument. That original sin has somehow been atoned for. Peru sells all of its government debt to foreign funds, so sovereigns are borrowing in local currency, but the private sector is almost exclusively borrowing in foreign currency. A government may face an issue. Let us imagine a government that faces a crisis, and let us call it Argentina. Argentina is a case where nobody was doing any borrowing, so it does not come up. However, say a crisis like the Argentina crisis comes to Peru and the government finds that its only way out is to substantially devalue the sol. It is not going to hurt government finances, because government liabilities are all in sols. It is going to bankrupt the private sector. That is going to be the political challenge the emerging markets are going to face, and by extension, the financial system is going to face it when these countries start facing difficulties. It is going to be a rerun of the ‘80s on steroids.

Daniel DAIANU

One could try to answer on the surface. I should not say superficially, but taking it as a working hypothesis, the system should stay as it is. I should not say we tinker on the fringes, but we should raise capital ratio, more capital. Admati and Hellwig have been saying for years that banks need to have much more inclusion in capital, and banks do not have it. Why? It is because of the system itself and the way it has been constructed over the years, starting with the ‘70s and a major decision of the American administration, the Nixon administration.

It has been increasingly destabilising. Financial markets have been increasingly destabilising economies. One could argue that the global system is over-financed, and finance has been extracting rents. Something has to be done about it. This is why there are people. By the way, we are almost not discussing it at all. Mervyn King and others turn it into air. We say there is something wrong with the basics of the system. We have to change the system, but this is very tough. It is like repairing the aeroplane while the aeroplane-

Jean-Claude TRICHET

What is the solution?

Daniel DAIANU

I am telling you the solution. I am telling you what I think should be done. When it comes to the euro area, as you mentioned, we have to complete the banking union. If the banking union is to be completed, it has to deal with fiscal arrangements. There is no other way. A collective deposit insurance care boils down to fiscal arrangements. You could call it fiscal integration, you could say that is fiscal integration, but it is a fiscal arrangement, which means mutualising risks. I do not see Germany accepting it. If it is not done, we will have an extremely fragile banking union, and it is a must. It has to be done.

Jean-Claude TRICHET

I am more optimistic than yourself.

Daniel DAIANU

It has to be done. You asked me what I think should be done, and I think it should be done. Secondly, there is what Olivier said. Germany also has to be pointed out. It is the policy stance. Germany is fond of saying rules have to be observed and we have to play by the rules. However, Germany has never accepted that such a big current account surplus has to be addressed, and that is also a rule, as the Commission have been saying for years. The limit is 6%.

This also has to be addressed. I believe that in spite of being capitalised, banks should have more capital. They should be, and they should be more robust. Related to that, we have to deal with the non-banks. Non-banks have to be tightly regulated. Many of them call themselves non-banks, but they operate like banks. They have to be regulated, the non-banks. We cannot allow such a big loophole.

Regarding policy coordination, Jeff said no way, and I agree. G20 was capable of doing something and it is much tougher nowadays because of the erosion of multilateralism. We see it is not happening in the Euro area as it should. However, we cannot accept it. We have to work hard and do something in terms of policy coordination. Otherwise, we are doomed. In addition, the example of Japan. We cannot close Japan. The rest of the world is not like Japan. Part of the rest of the world may turn into other Japans when it comes to how many residents hold public debt and savings and so on and so forth. The system should be much more resilient, because there is resilience in the Japanese system, but other parts of the world are not Japan.

ITOH Motoshige

I have three comments. One is on the financial crisis, the second is on QE, and the third is a point that I did not make, which is related to targeted inflation. Since I am from Japan, I know a lot about earthquakes. It is very difficult to predict an earthquake. It is impossible to stop earthquake. What we are thinking about is how we can respond after an earthquake happens. If you use that metaphor, can you predict when the financial crisis is coming or can you stop a financial crisis? Hopefully, but maybe not. Even prudence policy is mostly about how we can react in a good way after the financial crisis that is coming. It is better if we do not have a financial crisis. The second best is a smaller financial crisis, and then it should come more. Small earthquakes come more and then we can just have a less large amount of earthquakes.

I have a very good observation about the Korean financial crisis in 1997. It was very bad when I saw the economy. However, if you look at the data, say five years later or 10 years later, the Korean economy recovered very nicely. You cannot identify a very big, bad effect of a financial crisis by looking at the data over 10 years. The resilience in how we can recover from a financial crisis may be more important.

The second is QE. I will echo the chairman’s point. Since the interest rate is so low, zero for us, if have a very big shock, it is almost impossible to respond just with interest rate policies. The only remaining policy is quantitative policy and fiscal policy. In that respect, maybe quantitative policy will become more important when there is some kind of financial crisis. The important thing is, quantitative expansion is not only expansion or balancing. There is the other aspect and that is what you are going to buy. You can buy government bonds, you can buy assets from the stock market or you can buy from the foreign exchange market.

If Japan buys something from the foreign exchange market, maybe Mr Trump will be very angry, so I do not know whether it is politically easy or not. However, the stock price for example, the stock market may be a very interesting way to inject money. Also, when the financial crisis happens or the economy does not have a very good fiscal policy, sometimes it is very important. It is like when a bank has a problem with capital injection, it may be very important, and that may help. The negative impact will be softened.

The last point I did not mention is related to the point that was just mentioned, and that was the debt-GDP ratio. Japan's debt-GDP ratio is probably around 200%. It depends on how you measure the debt. Since we need to have some kind of balancing of deficit, it should be below 2-3%. However, even though we just have zero deficit for some time, that 200% can decrease without increasing nominal GDP. It may be very good if we can achieve a very high growth rate, but unfortunately, the real growth rate or potential growth rate is not very high, because GDP is not good.

The only solution is inflation. It is not very high inflation, but 2-3% inflation helps a lot, because most of the accumulated debt for Japan did not come from ageing. It just came from deflation and shrinking tax revenue because of the economic slump. Where inflation targeting should be set is very important, not only for the short-term problems, but more the long-term problems. It was very much related to the fiscal consolidation problem, although I know it is not very easy to achieve a high inflation rate.

Bertrand BADRÉ

I have four little comments. First, I will echo what you just said, Jeff. You have two issues with debt, which are the level and what it is used for. As I said, we could have used this period of low interest rates to prepare for the future and we have not, not enough at least. That is part of the issue. The quantitative element is crucial, but if it had been at least used to do something great, that would have been a different story.

There is a second point, to answer the question from Jean-Claude on banks. It is precisely the point we have made. We are back to focusing on different pieces of the puzzle instead of focusing on the holistic perspective of the puzzle. The ratio of banks is okay today. You can discuss things here and there. We have to finish with the banking union. Then we started and we still have differences in the financing of the economy. This was one of the issues before the crisis, when people argued that in the US, the markets are leading. In Europe, it is banks and in China and Japan, it is different.

It does not change. We had the marvellous slogan of the Capital Markets Union in Europe, which as far as I know is still a magnificent slogan, but there is no reality behind it. We have not addressed that issue, so we need to move back to a holistic approach. What do we need to finance this economy? How do we value equity investment versus debt investment? We have not discussed that. How do we mobilise money for infrastructure? How do we mobilise money for the long term? We have not addressed that. The rules have not changed. There is nothing.

My third element is a malicious comment, though not that malicious, on quantitative easing. Why did we never discuss green quantitative easing? It would have been an interesting occasion to allocate part of the money channelled into buying bonds specifically to green areas? Why not? I know central banks and I have had this conversation with Benoit, who was more open than usual. It was worth discussing. It was worth discussing. The last one is on Germany.

Jean-Claude TRICHET

I cannot help intervening. Then you will have absolutely all social and highly praised investment that will come to you.

Bertrand BADRÉ

There is a difference. Outside of the US, everyone has signed COP 21. It is a global engagement signed by the heads of state. It is not…

Jean-Claude TRICHET

There is the fight against inequality and for better education for everybody.

Bertrand BADRÉ

You buy 100 million in green bonds. It is at least worth discussing. I said it was malicious, but at least having this conversation would have been interesting, even to talk to the population, not just to have this technical discussion between bankers. My last point is on Germany. I love Germany. I come from Alsace and I have considered the Rhine not as a border but a way to cross, a passage or a bridge.

My only concern when we have discussions with Germany is when they have the moral high ground in the conversation. It is not necessarily that everything we discuss is rational, but we are right because we are right. That is where it is a little difficult. I say that and I am not participating in anything. I left Europe six years ago, but I feel that every time I go to Germany. I presented my book a few weeks ago and it was so obvious in the room, I could not believe it.

Jean-Claude TRICHET

I also disagree with you on that point, but we will discuss that later.

Sean CLEARY, Founder and Executive Vice-Chairman of the FutureWorld Foundation I am going to do this with great trepidation, but I want to build on something that Jeff introduced and Bertrand took further. The way humans behave is to develop a set of heuristics and then apply them consistently until the system fails. When we develop models for the purpose of modelling and simulations and related things, that is what we do once again. Simulations work brilliantly as long as the underlying assumptions associated with the simulation are effective. The moment those underlying conditions are no longer applicable, the simulation breaks down. That is how society functions too, and that is why we have revolutions from time to time.

There is a significant change in respect of social, ecological, and technological circumstances, and the institutional response to it is inadequate. Jean-Claude has made the point wonderfully in the past that in effect, the central bankers who had to grapple with the crisis in 2008 did not have textbooks. They did not have recently published articles that they could easily refer to, and in effect, they had to make policy on the hoof. That is why we refer to it as unconventional monetary policy even today.

However, the fact of the matter is, policy frequently has unintended consequences, and some of those are what we are grappling with. This is in respect of both the unintended consequences of extreme liquidity on the one hand and the issues that we have not addressed as a consequence of the crisis on the other. There is nothing surprising about that. That is what human systems do. However, what we are failing to recognise in a certain sense is that the system around the technical system is broken.

We are getting the rise of people from Duterte to Trump, from Putin to Erdogan, from Bolsonaro to everything else. This is not because of the fact that unconventional monetary policy produced too much liquidity in the system. We are getting that response because of the level of trust within society in the political institutions. There are also the economic manifestations of those institutions, including monetary policy, but it is a relatively small part of the whole. These are no longer seen by significant segments of many populations as serving a purpose.

That is the vulnerability, it seems to me, within which we will have to face the next financial crisis, great or small. There is the potential for escalation in conditions where social cohesion has broken down dramatically and social polarisation has increased highly significantly. Trust in institutions has been appreciably reduced. It is going to be far more difficult to come up with technical solutions to technical problems under those particular circumstances. Unless we use this moment to drive that debate forward, what we are properly discussing in this workshop this afternoon is going to prove likely to be impossible.

The trust that you could rely on, Jean-Claude, back in 2008 does not exist today. Bundeskanzler Merkel may not be the CDU leader in January of 2019. The Hessen result is probably going to cause a further loss of roughly 10% to the CDU. The Bavarian result produced a similar loss in respect of the CSU. There is the pressure that exists in respect of all of the central parties in the European space, before you get to Russia, Turkey, the Philippines, and Brazil.

The pressure that exists for those centrist parties, whence our norms come, whence that normative framework within which we are expected to deploy fiscal and monetary policy in order to bring about a restoration of stability, is fracturing. That is the most frightening element of the present moment. It is not something that too many of the speakers can deal with directly, but it would be a serious mistake to imagine that technical instruments are going to be adequate to deal with the next crisis.

Jean-Claude TRICHET

You are absolutely right. There is a consensus in considering that populism, the new wave of populism, is something which is now the main challenge for all political parties, leaders everywhere. This includes in a country which is succeeding admirably, in terms of employment and in terms of the cohesion of society, at least seen from the outside. Still, governmental power is vanishing.

In my own country, it is a caricature. Fortunately, it is not the extremists that are taking over, but it is a new centrist that is totally eliminating it. It is a real issue, of the traditional right and the traditional left. We all agree that it is the problem, and it is a political problem which cannot have a technical response. Nevertheless, the technicians have to bring about the best possible solution, taking things into account.

My own interpretation, though I do not want to monopolise this response is that we will probably have this problem for the next 30-40 years. The most vulnerable part of the population in the advanced economies is the working class, who are the less educated and the best part of the labour force. This will have competition from India, Brazil, Mexico, China, Indonesia, and so forth, for the next 30-40 years, on top of that.

Sean CLEARY

This is the post-industrial bio-digital revolution.

Jean-Claude TRICHET

Yes, it is on top of that. There are also the changes in values they have observed in society, which makes this anxiety gigantic, because it is an economic anxiety. It is obsolescence of skills and it is also a change in values. We have to tell political leaders and parties of all persuasions that they have a structural problem which is gigantic. They have to think broadly in this respect. It is not for us, unfortunately, to give the appropriate response.

Elena DALY

I will share my observation and I have a question. Thank you for bringing our discussion back to emerging market economies. Jean-Claude, you talked about the uncomfortably rising levels of debt, including and particularly in emerging market economies. In particular, what I worry about as a sovereign debt restructuring practitioner is the quality of the debt and the components of such levels of debt. This is in particular in non-Paris-Club bilateral indebtedness. This is obscured at the moment, but it will rise as a new problem from my perspective, having been in that space for over 20 years.

How would non-traditional bilateral creditors like China and India respond when their sovereign debtors cannot repay their loans? It will happen that they will not be able to repay their loans, so I see three options. One is negotiating ad-hoc arrangements, perhaps securing political or geopolitical concessions as a price for the forgiveness of such loans. Option two is joining the Paris Club and option three is forming a new club, such as the Beijing club of non-OECD members.

For example, in China, the major principal lender in emerging markets has dealt with the situation, using the first option, negotiating ad-hoc arrangements. Earlier this year, and we touched briefly on it in the panels, China secured 99% of the major ports in Sri Lanka, plus 15 000 acres of adjacent land, a very strategic piece, in exchange for debt relief, the total debt relief of Sri Lanka as a sovereign. Would Venezuela and Ecuador be the next contenders, using the same option? I hope not, so what would be the governance solution for that issue? I will be thinking about that, so I am just curious about what the panellists think about that.

Rozlyn ENGEL

I was going to try and to go back to the real economy for a moment and talk about growth. One of the things that concerned me a bit when I was in the treasury department was putting out a number like 3% when you know your labour force is growing at 0.3 or 0.4. You are putting a huge amount of faith in productivity growth, which is the key to long-term growth in per-capita income and in a long-term sense, what we are all seeking.

My question is 'Is there a role for finance in supporting, improving, and fostering productivity growth, or has finance been part of the problem?' Sometimes you hear the story that QE and extraordinary liquidity has propped up very low productivity firms for a very long time. We have not had this kind of creative destruction that we normally have during recessions, but this one was so terrifying that we just had to put a floor in there, and a lot of people were supported.

You also hear, or I have heard that because we are in a more IT and IP intensive environment, some of that is a little bit harder to collateralise. Financials are having a harder time lending to those firms or understanding the way in which to lend to those firms. I would just be curious to hear from you whether you think finance is part of the problem and also part of the solution, if there are things which should be changing.

Karl BRAUNER

I come from Germany. There is no government policy to create a trade surplus, so what do you want the Germans to do? I know Mr Schäuble always talks about the Swabian housewife, who only spends the money that you have previously earned. What do you want them to do?

Jean-Claude TRICHET

Jeff, there were a lot of questions which were of a political nature.

Jeffry FRIEDEN

A simple point on the German front is about fiscal policy. The German government plays a role, directly or indirectly, in wage negotiations. It has been back and forth, but two things have been pointed to. The first is undertaking a more expansionary fiscal policy. The second would be trying to encourage a loosening of some of the wage restraint that was so central in the early 2000s but is now counter-productive.

In many ways, one of the most interesting questions is the one that was raised about what China will do when its debtors start going under. As you say, we do have the Sri Lanka precedent, which is really a debt to equity conversion. In this case, the equity is pretty important. It is a 99-year lease on some things which some people believe are centrally important to Sri Lankan security. Since the amounts involved are very large relative to the country's economies, it will raise a whole series of political questions.

China may well find itself in the crosshairs of some nationalists. It already has in Sri Lanka, but it may find itself in the crosshairs of some pretty powerful nationalist sentiment. This might mean that it might want to join the Paris Club or talk to the fund about debt restructuring under the auspices of the fund. It would be foolish for the Chinese. This is not advice. It is advice, but it is free advice, so it is worth what is paid for it.

It would be foolish of the Chinese to maintain these things on a bilateral basis, because the history is that they always become politicised and always in a bad way for the creditor. Yours is the crucial question. If we only knew why productivity was slowing down, we could do something about that. I am struck by the fact that no-one has addressed this. I want to call it a hypothesis. I think it is a fact, but the hypothesis is that even today, in many countries, especially in Europe, the credit channel is fundamentally restricted or not functioning fully.

There is a lot of evidence. We have bank firm loan specific data for Portugal for example that shows that small and medium enterprises today still cannot raise all the funds that they need to. This goes back to the potential misallocation of resources, even with zero interest rates. When the credit channel is impeded, that means that good projects do not get funded. That is also true in the US, although not to the level of Europe, because there were so many bad loans on the books and there is so much risk aversion in the private sector that good projects are not being funded. I do not have an answer, but that would be part of it. It would be looking at the impediments to the credit channel.

ITOH Motoshige

I will just make a comment on the possible role of finance in raising productivity and growth. It may also be related to the current account surplus problem. Looking at the Japanese case, the so-called savings and investment difference divided by GDP has been 5.5% in the last 10 years. This means that the corporate sector has been accumulating about 60% of GDP for the last 10 years that they do not spend. In order to mobilise the economy from the supply side, investment is very critical, and not just for expansion of the capability. The more important thing is how they can change the business model as innovation.

In the case of Japan, this is very important. The government tried to stimulate and to move money which is already there and which is not used to the more active sectors, to the corporate sectors. In the German case, the savings and investment difference divided by GDP is at 2.6%. It may be better than us. You say less, but still, if that part can be used to stimulate the economy for the supply side chain, that may be more of a collection. I do not know how the government policy can move that, but savings and investment difference in the corporate sector is very important.

QIAO Yide

I am going to address the debt issue from a little bit of a broader perspective. I recall 40 years ago, when China started to open the doors of economic reform. They were also facing the financing issue. Unfortunately, I recall that at the time, they had a debt crisis in Latin America, so China was facing a situation where you borrow money from abroad or you do FDI, check the foreign direct investment. Fortunately, China is taking the second measure, which is successful.

I just read a book called *329 Days*, by a personal advisor for former Prime Minister Kohl. It was 329 days from the collapse of the Berlin Wall to the unification of Germany. When I finished reading the book, I suddenly recognised why the Soviet Union failed in some ways. In the end, they made a phone call. Kohl called Gorbachev. They were talking about money. They were talking about how much money Western Germany had to give the Soviet Union to get agreement from the Soviet Union to have the reunification of Germany. The Soviet Union also got lots of foreign debt to support their economic reforms, so that is the issue.

Also, back to the current situation, developing countries can still introduce some regulation and do private borrowings, overseas borrowings. Maybe that is not totally capital account openings, but after the global financial system, I am changing their position a little bit. In some way, the capital is still controlled in part two of the prudential management. In that way, for example, currently, if a private company in China wants to borrow money overseas, they have to get approval from the Chinese government. That way, China can control the foreign debt for private companies. Sovereign debt is a separate issue. It can be relatively controlled.

Bertrand BADRÉ

I have two quick comments. First, I would emphasise what you said. If by any chance in the next crisis, Odysseus and Hector could come to a good technical solution, it would be a very hard sell. That is a big issue, so I am afraid we will repeat the curse of the war of Troy. That is not to add a positive note to this end. The second point is about finance being part of the problem. There is one element. If my memory is correct, the highest weight of finance in GDP in the US and UK was 1929 and2007, so that was part of the problem. Now, one of the issues, after everything has been put in place is that finance is echoing the lack of trust in the system. I mentioned compliance, but it was bureaucracy etc. It takes much more time to do things. It is much more complex, and it is a drain on the economy.

I will take a tiny thing which I spent a lot of time on when I was at the World Bank, which is correspondent banking. It is below the radar and it is disappearing day after day after day. This is the relationship between the emerging and developing economies and the central system, which was handled by Citigroup, JPMorgan, and Deutsche Bank and one after the other, they cut the ties. That would be a problem for the global economy, which is not visible yet, but some day, it will surface. Then we will have another problem and there will be a backlash with the population.

Daniel DAIANU

Let us keep China in mind. China in particular has been behind creating alternative arrangements to the arrangements. It is happening in Asia and many countries have joined this, so I would use this as an analogy for the Beijing group, you said. I do not know how it is going to be called. It could be the Kuala Lumpur group. It does not matter. It is going to happen. Clearly, it is going to happen, and we should not believe that the guys in Beijing do not understand the pitfalls.

Secondly, about Germany, why does Germany have to think about the policy stance? Germany could have its own currency nowadays. The euro is like an undervalued Deutschmark. When it comes to the competitiveness and industrial strength of the German economy, Germany had experience with a much stronger currency, with a lot more unemployment. This is something that people should understand, and it is the task of politicians in Germany to explain it, however unpalatable it is for German citizens.

Last but not least, about finance, it may be that there is a lot which is wrong with finance. Finance is not like a bakery. Finance has a particular role to play. We could argue that finance has many of the attributes of public utilities. Finance may be frozen nowadays, when it comes to reshaping and redirecting its funding of activities and so on. In Germany, there is a *kreative Wiederaufbau*. We are talking in Europe nowadays about promoting promotional banks. We should set up a range of banks with the backing of the governments. We should fund new industries. Otherwise, we are going to be stuck. There is so much risk aversion and there is so much fear. Then there should be something where we go, there should be government intervention.

Give me a break. It is like an increased *Wirtschaft*. There are promotional banks in Europe, in Germany, in Austria, and even in France. The French government is behind banks, so we should not fear it. It is such an extraordinary set of circumstances, and we should be bold. I should not fear setting them up. Even in the United States, there is talk about setting up such a public finance institution. Why not? What is wrong with this? If we are blinded by ideology, we are going to continue to go in the wrong direction. We should be pragmatic.

Jean-Claude TRICHET

In the US, you have Freddie Mac and Fannie Mae, which are semi-public institutions. They are taking a lot of risk and are preventing the commercial banks from taking a lot of risks that are taken in Europe by the banks themselves. We are in a very complex situation as regards the financing of the economy on both sides of the Atlantic. If I may try to wrap up, first of all, we had a very good discussion with a lot of interaction.

I cannot help saying a word on Germany. The problem of Germany is twofold. One is the very big current account surplus, which is signalling something which is not absolutely normal. That being said, I share the view of Wolfgang when he says, ‘What do you want me to do?’ I do not command the industry and entrepreneurs and I do not command the unions. They have their own deal. All that we could do is encourage the unions to be more demanding, which was done by the German government and by the President of the Bundesbank.