

THE ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM - 2009

4-6 JUNE 2009, ST. PETERSBURG

FINANCIAL DAY

PLENARY SESSION:

POST-CRISIS FINANCIAL ARCHITECTURE

June 6, 2009

(10:00-12:00, Congress Hall, Pavilion 8)

St. Petersburg

2009

Description:

Global unrest and financial leverage reform. Reform of international financial institutions (creation of FSB, reform of IMF) and new forms of cooperation between ministries of finance and regulators from various countries aimed at restriction of global systemic risks (coordination, supervisory colleges).

Practical solutions for restoration and further development of the global financial system. Is the crisis a source of new opportunities and does it trigger enhancement of efficiency? Is Russian financial system free from “toxic assets”?

Moderator:

Tim Sebastian, Chairman of the Doha Debates

Presentations:

- **Chris Gibson-Smith**, Chairman of the Board of Directors London Stock Exchange
- **John Tsang**, Financial Secretary, Hong Kong
- **Sergei Kharlamov**, Deputy Head of the Federal Financial Markets Service of Russia
- **Elena Bakhmutova**, Chairman of the Agency of the Republic of Kazakhstan on regulation and surveillance on the financial market and financial organizations
- **Roman Gorunov**, Chief Executive Officer RTS
- **Arnaud de Bresson**, Managing Director Paris EUROPLACE
- **Konstantin Korishenko**, President MICEX
- **Sergei Pakhomov**, Chairman of State Debt Committee of the City of Moscow

Transcript:

T. Sebastian:

Ladies and gentlemen, a very good morning to you and welcome to this plenary devoted to the post-crisis financial architecture. My name is Tim Sebastian. Good morning and welcome to our today's plenary session. Hopefully, it will not disappoint you and exceed your wishes and expectations. Let's wait and see. Three trillion dollars worth of write-downs, millions of job losses and plenty of fine words of working together internationally to combat the crisis. But what has emerged? According to the economists the creation of a system that is more vulnerable and more dangerous than ever before. Why? Because the market itself has seen the state step-in when the worst happens so it will again let financiers take on too much risk. But that's just one deal. But yesterday we had Russia's President Dmitry Medvedev warning against making purely cosmetic changes instead of something that really works effectively. So my question to all on the distinguished panel this morning is - if we need new financial architecture, where exactly are the new architects? Is the talk really going to translate into something new and something concrete. I'm sure that we'll have some strong views on the subject. Let me introduce them to you. Alexei Kudrin is Deputy Prime-Minister and Finance Minister of the Russian Federation. Gertrude Tumpel-Gugerell is a Member of the Management Board of the European Central Bank. John Lipsky is First Deputy Managing Director of the IMF, the International Monetary Fund. Vikram Pandit is CEO of Citigroup. Joaquín Almunia is European Commissioner for Economic and Monetary Affairs. Andrei Kostin is President and CEO of VTB Bank. And Nouriel Roubini is Professor of Economics of the Stern School of Business and Chairman of RGE Monitor at New York University. Ladies and gentlemen, that's our panel. I'm going to ask them all to speak for a maximum ten minutes, hopefully not longer than that. Then I'm going to ask you to vote on a particular question and we will discuss for the time remaining the answers we get from you. Let me first of all ask Minister Alexei Kudrin to tell us how he visualises the post-crisis financial architecture. Mr. Minister, you are welcome.

A. Kudrin:

Thank you, dear friends. No doubt, we are currently undergoing the most severe crisis in the post-war history and maybe even since the Great Depression. This crisis is a special one, it looks, of course, nothing like other crises. What is characteristic of global economy in the most recent years starting from 90s? It is growth of globalisation. And it is safe to say that globalisation became the main factor in growth and recovery of entire regions worldwide. And those were capital flows that moved from the more developed countries to less developed countries as direct foreign investments (and lots of countries received these direct foreign investments and reached a fast rate of growth),

on the one hand, and started creating serious imbalance and generation of resources, in the case of positive balance of trade, in such countries as China, or, with high oil prices, in such countries as Arab countries and Russia, where large resources were created and forwarded back to more developed countries, on the other hand, but in the latter case, not in a form of direct investments: such countries as the U.S.A., UK, and other, in fact, used these resources for consumption, while savings in these countries came practically to a break-even point. These imbalances accumulated, and now we are facing not only the crisis of adjustment caused by excess production, not only adjustment caused by excess liquidity injected by Federal Reserve System in early 2000s, when they tried to mitigate effects of recession. All this created some bubbles, and not only in the U.S.A., but in other global markets as well. Of course, we have to see deeper causes of this crisis. This is a crisis of globalisation, however, a positive one, it urges us to develop new institutions regulating globalisation. We, therefore, need to answer the following question today: what kind of institutions those will be? At present, in my judgment, the largest problem is in the emerging markets. Those were the emerging markets that lost the largest amount of capital. According to World Bank, in 2007, an inflow of capital in the emerging markets totalled \$618 billion, while in 2009, an outflow of \$190 billion is expected. Another imbalance is in the fact that last year, a current account deficit of the U.S.A. was 600 billion, while a surplus of cumulative external account of the emerging markets totalled 900 billion. In fact, we hit up against the limits of opportunities and capacity of markets, and so far, this imbalance has not been disposed of, and mechanisms, including those of the crisis, aggravate this imbalance. Yesterday I mentioned at the meeting devoted to protectionism that today it is no longer sufficient to regulate global trade only with the help of rates and lines of rating measures. Exchange rates can materially change competitiveness in trade. And exchange rates shall not be discarded in regulation of trade today, nor shall be exchange rates regulated separately. It happened so that exchange rates and trade are regulated by different institutions, but today, I am ready to look at it from a different point of view. Whenever such imbalance occurs in countries or in balance of payments, other rates and, as a result, other trade flows occur. All these are interrelated, therefore, we need to regulate not only individual markets, we need to seek for integrated tools that will be able to ensure stability of markets, stability of global economy. Of course, those solutions that are elaborated by the Group of Twenty are intended to solve these problems. It is, first of all, reform of the system of surveillance of global finance and creation of an effective crises early warning system, coordination of macroeconomic policies of the large group of the more developed countries and less developed countries, creation of an international system of financial regulation that would step over the bounds of national states. The main thing we keep disputing in the Group of Twenty is how strict this regulation should be, or whether those should be some kind of recommendations to be followed by certain countries and neglected by other. I would

give an example of EU, which has already established currency regulation at a national level, and, by the way, in conditions of this crisis, the European Central Bank has maintained more careful and deliberate currency regulation than that within the national boundaries of the U.S.A., where mitigation of the problem with unemployment and the current growth have been put first regardless of possible imbalance, which causes heavy introduction of liquidity to the global markets. We expect that if today such liquidity issued by Federal Reserve System and other central banks supports demand, as soon as any evidence of inflation occurs, the global market will be gradually cleared from this liquidity, and our emerging markets will lose some part of their capital again. It happens so that we permanently depend on national, pretty selfish, activities of large reserve systems. Therefore, the issue of regulation, whether of financial markets or macroeconomic parameters, is beyond the boundaries of national economies. We have to head for the elements demonstrated by EU today, i.e. to regulation of macroeconomics of key indicators, whether fiscal branches, or exchange rate, or other standards, which have to support such complex integrated regulation systems. What I would like to say, it is impossible to create any new reserve currencies or a more stable currency system merely having agreed to do so. This means integration of economies, this means integration of methods of regulation. Methods of regulation in China, for example, and their institutions differ greatly from other countries. The same applies to CIS countries. We are very different, we need to synchronize a lot – legislation, methods of economic policy. What is going on in the EU, is as one of the experiences, however, there are certain frictions even there. Therefore, I do not expect any new large currency unions to appear in the nearest future. I believe that it is the shortest way, if China liberalises its economy and decides to make Yuan convertible. I think it may take about 10 years and thereafter, this currency will become quite popular, and this is the shortest way to create a new global reserve currency. I have a feeling that China is mulling the idea. In search of alternatives to the current world order, we all of us certainly noticed that the US' excessive budgetary gap is the reason for mistrust to dollar, that this gap needs to be reduced, that the US government issues a challenge to reduce it in 2 or 3 years to 6% by 2011. But I think it is going to be extremely challenging, as they will depend on political reality, desires of electorate, these are realities of any government of any state. We therefore have to look for solutions under the auspices of team actions. Those may be actions of leading institutions like International Monetary Fund, Financial Stability Council, etc. But in this event, International Monetary Fund has to become a true representative of leading economies of the world. It is nothing like that today. At present the share of US votes accounts for 15%, China has less than the share of some European countries, e.g. Switzerland or Belgium. We therefore have to be really bold and raise the point of making IMF representative of leading global economies that would be worth the name. And forces have to be pro rata to strength of respective economies and their role in global

economy. I know that this currently under discussion. We set a goal to reach an agreement by January 2011, but we have already come across a lot of prevarications and trips. So it is not going to be easy. Thank you.

T. Sebastian:

Thank you very much, Mr. Minister. I have not noticed much optimism in your words regarding creation of a new financial architecture. Am I right?

A. Kudrin:

On the contrary, I believe that ways are clear. I gave an example of the EU and see that we have to work out macroeconomic regulatory measures to the extent of parameters to be complied with by leading countries, including the U.S.A., on a mandatory basis. So far, the US are not ready to accept such solution, but we see that all of us will have to follow this way. And we will in any case have to transform IMF into a new institute in charge of such regulation....

T. Sebastian:

Thank you very much indeed. Now let me ask Gertrude Tumpel-Gugerell to tell us how she sees the post-crisis financial architecture.

G. Tumpel-Gugerell:

Thank you. First of all, let me say it's a pleasure to be here at the economic forum and to be talking about the international financial architecture. We think it should be as solid and as long lasting as the architecture here in St. Petersburg. But we are not yet there. I think it is important to mention that Russia is a very important neighbour for the European Union. The economic inter-linkages are getting closer and closer and it's also been a counterpart for many of our banks in the last few years. Engagement with and exposure to the Euro area banks has doubled and linkages are becoming more and more intensive. So, we have a common interest in financial stability, just as it is a common interest for the global community. I think there is now a window of opportunity to reinforce the financial architecture, however the window of opportunity will not last very long because more markets are normalising. There is an impression that there is less need for reform: this is clearly an inaccurate assessment.

Let me start with the main challenges we see. First of all, we have seen a severe undervaluation of risks and a lack of transparency. This has led to disruption in the markets and has made the financial system very vulnerable, especially due to the underestimation of liquidity risk. Furthermore, the ECB and other institutions warned of these developments in the previous few years. We may also

say that sufficient attention was not given to macro-prudential supervision. Macro-prudential supervision is not easy to make operational, but it is clear that a major focus of reform must be placed on the systemic perspective, on the inter-linkages between financial institutions. Therefore public authorities must act - especially on this issue of systemic risk, as it has been proved over the last few years that self-regulation is not sufficient. A number of policy initiatives have recently been initiated and they must always be implemented at a national level. In the end, national governments take decisions regarding problem solving during situations of financial crisis. However, it is important to act in a coordinated way - I think that was a great success of the G20 summit 2 months ago. I think the first priority should be on the strengthening of macro-prudential supervision. Global monitoring of systemic risk is important. I see three institutions which have the responsibility to do this. Firstly, the Financial Stability Board, whose membership has been enlarged. I think they are in the process of developing macro-prudential tools along with the Bank of International Settlements in Basel and the IMF. So we expect early morning exercises. I think the first examples have been given a very important role for these three institutions. Second, we also need to undergo a global and regulatory and supervisory repair. The Basel committee has made some proposals, which were published last year, regarding especially liquidity management and also including a review of the Basel II framework, the capital framework. I think one of the major weaknesses in the current system is procyclicality. I think we are seeing the first proposals now to address procyclicality; the financial stability board is also working on this. It's an important task. I think we have a good example of a country that has managed its procyclicality risk better than others in the past and this is Spain.

My third point is that the regulatory gaps need to be closed. In that respect, the G20 leaders also endorse the extension of the regulatory net to all systemically important institutions, markets and instruments. This includes hedge funds, private rating agencies and also over-the-counter derivative markets. I think that a lot of emphasis needs to be put on greater transparency and also on the introduction of clearing of exchanged trading for these type of businesses. And also here the IMF and the FSP need to develop guidelines to assist their systemic importance by the autumn. What will we do in Europe? First of all, I think it concerns the upcoming discussion between the finance ministers next week. We hope that the finance ministers will decide on the implementation of the so called "Belorossiya Group" recommendations. The idea is to establish a European systemic risk counsel for macro-prudentials supervision, which will be operated under the auspices of the European Central Bank and the system of central banks. The counsel would identify and prioritise risks to financial stability; issue risk warnings; and if necessary give recommendations on measures to be taken. The creation of this counsel would constitute a major mile stone in the reinforcement of arrangements for the safeguarding of financial stability in the EU. The second

issue is that, in this context it's important to ensure the necessary access to information for this risk counsel. Of course, there has to be agreement and also the necessary legislative action in order to allow a European level of access to these individual institutions, information and development. A second issue in this complex is that the risk warnings and recommendations should be effectively translated into all our actions. This requires adequate monitoring and enforcement mechanisms. A global dimension for financial systems also requires strong cooperation between this risk counsel and the IMF and the FSP. However, in the end all financial stability starts at the local level, therefore it's important to keep the political momentum for reform and to ensure that all national frameworks are adjusted and amended according to best practises. Let me also underline here that the Euro system has very good cooperation with the Russian Central Bank and since 2003 we have cooperated on banking supervision issues. Since April last year, our cooperation has focused very much on the implementation of the Basel II framework in Russia and, of course, here the new amendments and new developments also have to be taken into count. Let me conclude: the international community is working towards a post crisis financial architecture; it should give more prominence to macro-prudentials; orientation should be based on the strengthened regulatory and supervisory framework and should prevent regulatory arbitrage as it happened in the past. It's important to keep the momentum for reform; it cannot be underlined how important this is and it should not only be superficial. It's important to coordinate the policy initiatives at a global level but also to swiftly implement at the local level. I think if we achieve this lasting reform, as I said at the beginning, it has to be not only swift enough but also deep enough. Thank you.

T. Sebastian:

Thank you very much indeed. You said at the beginning that the window of opportunity is closing; do you already detect resistance to structure reform in some European governments, on the basis that the crisis is, in their eyes, already coming to an end?

G. Tumpel-Gugerell:

Each institutional change and its transfer of powers and, for instance the building of a European architecture for supervision, is of course, to certain extent, also transferring power, or at least sharing information. I don't think it is easily done, but I think it is necessary. I think it has more commitment now. It's not easy for governments, but I hope we get a good result and see concrete progress.

T. Sebastian:

Thank you very much. John Lipsky, the view of the IMF please.

J. Lipsky:

Thank you very much. First, thanks to the organisers for the honour of inviting me here and I would just like to note that my colleagues who follow Russia recently concluded their so-called "article 4" annual visit to discuss with the Russian authorities the outlook for the Russian economy. I want to thank them for their cooperation: we had very, very excellent dialogue. We've already heard what I think are some very salient, very coherent comments. I'd like to say Tim, right from the start that I think there are real grounds for optimism about the evolution of a more effective international architecture. And I don't want to repeat some of the excellent observations already made. But let me give a very brief architecture tour of where we came from and where I think we are headed. Let me go back even beyond 1990, let's go back all the way to the foundation of the Bretton Woods system in the wake of World War II. That system was founded on three key institutions to deal with three key issues that were viewed as having caused the great depression in World War II. One, on the economic side: the insight was, that the collapse of world trade and the collapse of the finance supporting world trade had helped lead to the conflicts. It was not only the great depression that helped lead to World War II. The three institutions created to deal with those problems in the post war era were: first, the United Nations to deal with security and political issues; the GATT, now the World Trade Organisation, to ensure that trade protection was never allowed to resurface in the way that it was in the 1930s; and third the International Monetary Fund was created to make sure that the international financial channels that supported international trade were not allowed to close as had occurred in the 1930s. But there were some significant limitations on the IMF, at the very least as it was initially created, and also on the GATT. In both cases, although they were conceived ultimately to be global institutions, they were not global institutions. At its outset the IMF had only 44 member countries, compared to today - 185 member countries. Second, membership in the IMF implied a commitment to open financial flows in support of trade transactions. But in fact, there was no initial agreement about the role of the IMF or about the role of capital markets in general. First of all, international capital markets, as we know them today, simply didn't exist. Secondly, some of the architects of Bretton Woods, of the IMF actually thought that international capital markets should not be allowed to exist because they thought they will be ultimately destabilising.

So let's fast-forward. That world helped produce dramatic improvements in the global economy but ultimately had its limitations. Now fast-forward to 1990, another benchmark moment in the evolution of global architecture. With the transformation of centrally planned economies, the IMF

became a global institution and moreover something we could call a global trading mark actually emerged. In the long side, globalisation, as Mr Goodman mentioned, evolved international capital markets in a way that simply didn't exist before. They evolved in the context in which there was no clear international oversight or regulatory framework to govern their growth. As a result, there was ad hoc oversight and, importantly, given the rapid growth of international capital flows as well as the dramatic relative shifts in the international economy and the rapid growth of many emerging market economies, the IMF, which was the international body charged with maintaining economic and financial progress and stability, had no effective crisis prevention instrument for a world of fast-moving, securitised, international capital markets. And that helped lead, we saw, already in 1994-1995 with the Mexican peso crisis. We could see that the international safety net was simply inadequate to deal with the developments that were transforming the global economy: '97-'98; 2000-2001; again and again we saw concrete proof that the architecture was not adequate to maintain stability, given the facts that were emerging on the ground of rapid growth in trade; rapid shifts and relative weights on economic performance; and the explosive growth of international capital markets. Now we've had this crisis. What is evolving in the wake of this crisis? It seems to me that, although some of the ambiguities that I've just described have not been fully resolved, at the same time some important advances have already been agreed, some of them have been mentioned already. First of all, on the regulatory side, as you've heard, the Financial Stability Board has been created, has been charged with dealing with two basic regulatory flaws that were made evident in this crisis. First of all, something that we call the perimeter of regulation had been poorly drawn and that systemically important institutions were in some cases left outside the regulatory framework, or in some cases they were allowed to put risks off balance sheets out of view regulators even when the institutions themselves were regulated. So, one, perimeters of regulation needs to be redrawn and secondly, as we've already heard, macro-prudential aspects have to be taken into account for effective regulation. In other words, regulators cannot just focus only on institutions and instruments but also have to take into account systemic leverage and the effects of the economic cycle.

But for the IMF as well, some important changes have taken place. Our membership 15 years after the Mexican peso crisis has finally approved a crisis prevention instrument for the IMF that has a chance of being effective in a world of securitised finance. This is the flexible credit line that effectively allows the IMF to write insurance policies for sovereign risk; to help protect our members against sudden stops of capital flows for those economies following excellent policies. We've also been charged, as you've heard from previous speakers, with some important new responsibilities. But let me just explain briefly how we relate to the Financial Stability Forum. As you've already heard, the IMF is a member, an active member of the Stability Forum, but we are not

regulators and we do not aspire to be regulators. We think that our expertise and insights allow us to contribute to the agreement and negotiations in the FSB around the evolution of new regulations but our role is ultimately to oversee and monitor the implementation of the regulatory standards agreed at the FSB. In addition, we're cooperating, collaborating with the FSB in the new early morning exercise. And as Minister Kudrin already mentioned, we've been charged with beginning the process and extending the process of redrawing the governments in the IMF, with a benchmark to make real concrete process by January 2011. Specifically, in the coming quarters, we're going to be also discussing with our members the need for an effective, coherent and credible exit strategy from the liquidity provision and fiscal stimulus that has been put in place to help overcome crisis. But looking forward: are we going to be able to restore the free flow of capital; to restore the flow of capital to emerging markets that should in the future continue to be the fastest growing areas on the world and do it in a way that promotes greater stability and effectiveness? Frankly the answer is: it depends. We have to avoid trade protection and we have to avoid allowing the measures being taken today to create a new form of financial protectionism. We have to actually implement the new agreements that will be forthcoming on financial regulation and we have to avoid the temptation of individual countries to turn toward self insurance by trying to run current accounts surpluses and build up international reserves, rather than help contribute to a cooperative, collaborative, coherent and effective international system. There are big challenges ahead but, Tim, the answer to your question: I'm optimistic we're making real progress. Thank you very much.

T. Sebastian:

John Lipsky, thank you very much indeed. You saw encouraging signs in the creation of the new regular trade framework. What about enforcement mechanisms, it comes down to that. Doesn't it?

J. Lipsky:

Of course it does. But the degree of collaboration and coherence that has been evident in the new G20 process, in the amount of fiscal monetary stimulus and regulatory cooperation and agreement over what needs to be done, offers a lot of hope. As I said, that fund has been charged with the job of monitoring the implementation of these new agreements but at the end of the day it's going to require national efforts. Thank you.

T. Sebastian:

Political will in other words.

J. Lipsky:

Exactly.

T. Sebastian:

Thank you very much. Vikram Pandit, your views please on the post crisis financial architecture.

V. Pandit:

Tim, thank you, thank you very much. A lot of what needs to be said has been said. I'm going to share some views from the point of view of the practitioner. A little bit more micro than macro. We all understand by now the macro causes of why we are where we are. The question we keep asking ourselves is didn't the markets handle this. Now we knew all these imbalances were there; we knew a lot of these things before the crisis. What is it about the markets that did not lead them to readjust; to anticipate some this; and what is it about the markets that didn't handle it? There's a lot of debate about whether this is a free market philosophy and you keep talking about that. Invariably you keep coming back to this idea: it's really not about that, as much as it is about how we practised it. It's a lot more to do with the architecture around which the market are structured. To us, it keeps coming back to two things: governance and market structure. If the goal is to design the market structure so that practitioners can anticipate a lot of the macro issues and transfer them to micro response, that gets markets to clear efficiently. You have got to have trust; you have to have transparency; you have to have common standards. However for us, all that it really comes down to is the right governance structures and the right market structures. Let me spend a little bit of time on both. We've talked a lot about governments at the macro level. If you really peel back the issues on governments, they start right from certain central banks, for example by way of believing inflation versus growth is their target but not financial stability; or by the way in places like the US having a large shadow banking system. Almost 50% of the credit creation in the US came from the shadow banking system but it was a non-regulated part of the financial architecture. It's about different standards for capital; or different types of institution, by form rather than by substance. Large parts of the fixed income markets, particularly credit markets, were opaque. You don't really know the price, or the size, or the volume in a lot of these markets. It's hard for markets to clear when you don't have the information.

Incentives. We talked about compensation, but incentives were not necessarily aligned with the long term interest of financial stability and the most important thing is that there were tremendous causes for moral hazard. I go back to perhaps the single biggest revolution in the last 5-7 years: this concept of risk transfer. People who originated risk did not have to own it. They could sell it on. Just think about it: you can originate it and you can sell it on. That's a bad situation for a lot of

moral hazard issues and comes back to the fact that perhaps there were not enough standards or checks and balances against those originated risk versus those of distributed risk to those who actually owned risk. A lot of these are terrific micro issues that all have to get incorporated into simple things, like you have to cast a wide net and not a large non-regulated banking or shadow banking system - that doesn't lead to financial stability. However you think about it, you have to cast a wide net. There's no question that governance is a lot about transparency, a lot more sunshine is a good thing. For markets to clear it's about standards: standards on capital; standards on accounting that are coordinated and global; standards on rating agencies; and of course, as has been discussed, it's about the need for systemic regulators, who then become the aggregators of information when all other markets cannot aggregate it they have to be in the goal post looking at how does the system looks. These are issues of governance. The good news is that all these are the questions that are being asked and there's a lot of good debate on these questions. I have a great deal of confidence as we keep debating that we're all going to come to some common understanding about where we go with governance. You don't have good markets without good governance: it's not about capitalism; it's not about free markets: its good governance and free markets together that can cure markets.

Let me get to the point about market structure. I'm just going to highlight two areas that are particularly opaque, particularly lightly regulated or non-regulated. The first is the over-the-counter markets. It takes something like credit default swaps. This is a market that went from nothing to trillions of dollars in 5-7 years. Inherently opaque, no clearing houses, no exchanges. There has to be a view that, on a very micro basis, we have got to try everything we can to move over-the-counter markets to more transparency. The market needs information to clear. Markets needs information to clear: more clearing houses, more exchanges - not necessarily a popular thing from the point of view of practitioners who make more money sometimes in opaque markets - but it is important for systemic stability and we believe in that. So, moving towards greater transparency through standardising and moving as many markets - you're never going to be able to do all the markets - but moving as many markets as possible towards clearing houses and exchanges is a good thing.

Let me focus on another thing: the shadow banking system in the US. This was a banking system to create loans not funded by deposits. It was a banking system that borrowed money in the capital markets. The form of loans, commercial paper, and other things turned around and turned that money into loans through finance companies. Concepts of securitisation. There's a whole host of different shadow banking activities, happening, by the way, away from the eyes of regulators, with capital standards that were not well articulated and we relied on the rating agencies, as an example. I don't think we're going to be able to do that when we're going forward. There's a real question

about the shadow banking system: not only because we need to cast a wide net and take it into regulation, but because of a problem we're facing right now, on a very micro basis. That problem is that half the credit creation in the US came from the shadow banking system. This particular area is really at a standstill. How do you create credit? How do you help world trade, trade commands? How do you do that when half the credit creation came from an area that's no longer working? It's not only a question about architecture going forward, but there are some questions about how you want to deal with those things today. The reality, in our view, is that all the deposits in the world themselves - if you add them all up, are not going to be enough to drive the amount of credit creation to have the proper kind of GDP growth that you need. You have to have some alternatives to deposits as a way of driving credit creation, which means an outlook around the shadow banking system is very important to us.

I thought I'd share with you just a couple of thoughts here. We do believe, by the way, that the right path of dialogue is occurring around a lot of governance issues. But we need to see greater dialogue around market structure issues. These are things of interest to all of us as practitioners. What you find is that you invariably have to rely on regulators to help you design the right market structure. If free market dialogues will not necessarily lead you to the right market structure, you need exchanges to be mandated; you need clearing houses to be mandated. So, we'd like to see the dialogue for all of us not only focused on governance, as we've talked about, but to get going beyond that, to thinking about shadow banking systems, market structures, securitisations, what we need. By the way, during the Great Depression, people didn't want to put money in banks because they didn't think money was safe. So deposit insurance was formed as a way of saying: "it's OK, don't worry, put money into banks and they can create loans and your deposits are guaranteed." These are very clever solutions to the shadow banking system. Those are the kind of questions that I think are very important for the future.

T. Sebastian:

Vikram Pandit, thank you very much indeed. You asked a question at the beginning about why the markets didn't handle the crisis situation when they knew what was going on. Could the answer be that they didn't want to handle it?

V. Pandit:

Well, to me, it goes back to the question of incentives. Again, the question of incentives in the financial system and the fact that we need to focus on that as principles: what they should be is a really important issue. You don't get into a situation of the sort that we got ourselves into without tremendous issues of moral hazard somewhere in the financial system. And so, maybe we don't

want to ask the questions at a variety of different levels. However, to us in the financial system, on a micro basis a lot of that has to do with some of the incentives in place.

T. Sebastian:

Thank you very much indeed. Joaquín Almunia, can I please ask you from the European Commissioner's perspective?

J. Almunia:

Thank you. Thank you very much. Well, I think we all agree that changes are necessary. I don't know a single voice that is now saying in public, at least in public, that we should return to the past situation before the crisis. I have seen the temptation to consider that we can come back to business as usual, but the official language everywhere is that a lot of changes are necessary. The question is what changes and who will carry out these changes.

What changes? First of all, from a political point of view, the question is quite obvious. We will need more regulation of financial activities, market services, and better regulation. In some cases, more regulation, where there was a lack of regulation, for instance in some of the elements that Mr Pandit just mentioned about shadow banking; but better regulation. The issues to be regulated - or those that are being regulated after the crisis or were regulated during this crisis, or need to be examined in the future - have been mentioned: the modifications in the capital requirements regulations in Basel II; rating agencies at the European level have been regulated; hedge funds and these kind of institutions are being regulated in Europe. There is a matter of concern: do we include these kinds of activities within the perimeters of regulation? Derivatives on over-the-counter activities, accounting standards have to be reconsidered, to some extent, to avoid procyclicality from this point of view, and this is a work that is being done. So the list of things to do to change the regulation or to adopt new regulations is more or less a matter of consensus after all the discussions that took place during the last one-and-a-half-years or close to two years, both on the European level and at the global level through the G20 process. The action plan that was adopted in the Washington Summit of G-20 last November that was updated and monitored during the London Summit is a very, very comprehensive one.

Who should regulate? We, at the European level, in the EU, have our own list of things to do. We are doing those things. We are monitoring the roadmaps of things to do that were adopted in the past year-and-a-half. Whereas before the crisis, it was not easy to discuss and to adopt certain regulations in the financial sector at the EU level because the continental views and the British views were not exactly the same. Now, during the crisis, during this period of experiencing a very

deep crisis, the convergence of views has increased. I think would it be easier to end the full list of actions of new regulations or changes in the regulation, that had been decided at the European level. At the global level, as I said, G-20 has also established a very comprehensive road map of actions and action plan. Consensus is also evident in most of the issues - at least before going into the details of these regulations. We can discuss the question at the global level at the political level: but who will adopt global regulations? We have the standard setters: the FSB, the Financial Stability Board; or the Basel Committee; or the Institute for Accounting Standards, but they are not able to produce binding regulations. They produce ideas, recommendations, standards, but these standards should be transformed into binding regulations everywhere. We are living in a global world and for obvious reasons the financial aspects are more global than others in our economy. So, we have at the global level this question mark. We can agree at the political level, but the day after, the follow up of the political decisions is not as evident about the procedures, about who will adopt the initiative, how to discuss the different regulations in the different sectors. These are questions that we have solved at the European level among 27 member states, but are not fully solved at the global level. We will see.

Second point: after regulation comes supervision. And we have here serious difficulties to be solved. We have serious difficulties in Europe. As Gertrude said before, it's not easy at the European level, even if we have our own system of regulation, to put together financial supervisors that are national-based; that are operating at the national level. They are reluctant to share information. They are reluctant to accept the binding mediation when they disagree in the way to supervise one institution operating cross-border in Europe. If we have these problems at the European level, we can imagine that at the global level these questions are not easy. And these questions are very important because we have in our present economy dozens of cross-border financial institutions operating in many countries at the same time with systemic consequences, if they have problems. We need to organise a system of cross-border supervision. We have launched at the G-20 level the idea of colleges of supervisors; to put together the supervisors of one single institution operating in many countries, but it's not easy. We will need to think a lot more about this kind of issue.

And the second question of supervision has been mentioned – I will not elaborate on this – it is the macro-prudential supervision: how to assess risks for financial stability of a systemic nature. This is done using the information that the micro-prudential supervisors obtain from the individual institutions and drawing the global consequences of these risks, assessed at the micro level; by drawing conclusions and by producing warnings, and, if this is the case, making recommendations to avoid the materialisation of those risks and creating systemic problems. This system of macro-prudential supervision is being launched at the EU level, with the future systemic risk council and

systemic risk vote that will be launched in the coming weeks. Regarding the global level, we are discussing a similar system at the global level with the IMF and with the FSB.

A third point regarding regulation is that, in the future, self-regulation will not be as important as it was in the past period. We will not trust self-regulation in many areas because we have observed some big failures as a result of this excessive confidence, but risk management cannot be imposed through legal mediation. Risk management is about managing each of the banks or financial institutions, but it has been judged one of the origins of the bad incentives that brought us to the crisis.

Remuneration schemes. We can issue recommendations and, in fact, we have issued recommendations on how to establish good remuneration schemes that will not create bad incentives; that will not be procyclical, and so on and so forth. These decisions should, by definition, be adopted and considered at the level of each one of the banks or financial entities. This is a very important issue. The consequences of all these are, I think, clear. The future financial system will be less procyclical, or should become less procyclical, because of these decisions and through the regulation. Other kinds of decisions will become more regulated and less leveraged. So, in the coming years, the positive support, coming from the activities of the financial system, towards the real economy will not be as big as it was, and this creates a very important question regarding the strategies and actions to be developed in the known financial side of our economies. We need to structure our reforms. We need to introduce more dynamism, more resilience and better functioning of our product services and labour markets.

And a final point. I will not elaborate on the multilateral institutions: IMF, FSB. The role of the EU is well known. The role of the G20 is to launch ideas; to create consensus; and to monitor the implementation of decisions. This is crucial and I hope it will continue to be crucial. But we have at least two risks. First, we need to find a way to discuss how to adjust the macroeconomic global imbalances that are at the origin of this crisis. This crisis has clear origins in the failures of financial regulation; in financial supervision; and in risk management; but there are also macroeconomic factors coming from the global imbalances in the global economy. So far, we have not worked out how to deal with an orderly adjustment to these global imbalances. The IMF tried to do so two or three years ago, but in the end nobody was responsible for developing and implementing the intellectual conclusions of that exercise. And a second point: given that, in many of our countries, the public resources and the public sectors are obliged to intervene in the financial sector, in order to rescue institutions; to support the capital base of banks to give guarantees; to help the improvement in the functioning of the financial activities of our financial markets; given that the treasuries are national, we run the risk of renationalising the strategies and the business models of our financial institutions. This de-globalisation of the financial markets and of financial activities

would not be at all wise. So we need to use public resources when private capital is not available, in order to restore credit; to clean up bank balance sheets; and to try to fix the consequences of the crisis. However, we should not be complacent in the face of the temptations of financial protectionism, and the temptation to renationalise the scope, the strategy, and the business model of the financial institutions. Thank you.

T. Sebastian:

Joaquín Almunia, thank you very much indeed. Andrei Kostin, please.

A. Kostin:

Thank you very much, Tim. I think it is always easier to speak at the close of discussion, when a lot of things have been already said. I believe, globalization of economy, globalization of financial markets has been always ahead of globalization of political processes, state institutions. In this respect, we can probably say that we have global economy, but we have no global government, global institutions able to deal with the problems we are now talking about, including creation of a system of regulation. Therefore, prizing results of, say, the meeting of the Group of Twenty in London, I am, however, quite sceptical whether we can succeed in creating a global system of regulation that would enable us to create effective regulation control mechanisms, albeit it should be admitted that, no doubt, we are apt to do so. This process is likely to exist. I would note again that, say, the problem with off-shores, the Great Eight has been dealing with for a couple of decades already, still remains open. The Group of Twenty was forced to raise this issue. In fact, such kind of ideas need to be worked on more than one year, therefore, I believe that in the nearest future we will have to rely on national regulatory measures, which are sure to change drastically. Having mentioned this, I would certainly like to remind you what President Medvedev said yesterday in his presentation. He warned us against going the limits, against creating a too tough system of regulation, which would largely limit the development opportunities of financial markets and economy at large. I was to the US three weeks ago and in Washington, I had meetings with lawmakers in Senate and in Congress, listened to TV, and I got an impression that: first, there is no more important problem in America today than bonuses of AIG management and second, lawmakers of both the Congress and Senate are up in arms against banks. They kept saying they would take a number of strong measures to restrict activities of banks, tighten the system of regulation, etc. It seems to be very dangerous now, when crisis is in full swing, being governed by populist spirits, to create such severe framework for further development of business, including banking, which will prevent us from pulling out from the crisis at pretty high rate. Tim asked a question if we wanted to get the message or not? I think we were creating together the economy we have created, and all of

us were pleased with it, as governments gained economic growth, jobs, opportunities in dealing with social issues, political stability. The population used to have cheap mortgage, unlimited loans, capitalization of business, the Forbes list had grown into a ten-volume publication, profits of banks increased, they received bonuses, which means that the entire economy was quite a success to the satisfaction all concerned. (???) Now we say: yes, we danced away our chance, we missed, now we have to redesign everything. I believe the approach has to be deliberate enough. We have to be realistic in our appraisal of the progress made by the bank, financial banking sector over the past decade. This is our common achievement, and we can build a more developed economy and a more advanced financial system on the base thereof. Nevertheless, I can foresee that in the nearest future, speaking of the ideology of approach to financial markets, we will tend to the so-called “3D”. The first D is de-liberalisation, as the role of direct interest of the state grows. I cannot miss the opportunity to say that the Russian Central Bank provides money to foreign banks working in Russia, while our attempts to obtain money in Europe from the European Central Bank were so far in vain. This, of course, concerns protectionisms and mutual liberalism. The second D is de-globalisation. It is important to recognise that those are not banks that are more oriented on key markets today. This means that the area of activities is obviously shrinking today. We can see the tendency for de-globalisation, at least in the short run. And, at last, third D, which is, of course, deleverage. Everybody says now that too many risks accumulated due to leverage, and the level of leverage in economy and financial sphere will to a certain extent reduce in the nearest future. This is the near-term trend, and still, no matter how sceptic I am about any fast changes in the sphere of surveillance and state regulation, I believe in market. I believe that supported by national and governmental programs, the market will be able to recover pretty soon. You know, in August 1998 (the crisis in Russia was in full swing), I met a colleague of mine from a large foreign investment bank in Sheremtievo Airport. He told me: “Andrei, we will be back some time. He came back in 2003. Now he is packing again, but somehow I feel he will be back again. Thank you.

T. Sebastian:

Nouriel Roubini, your views please.

N. Roubini:

Well, my first point is that, whilst there is a lot of talk now about the reform of the international financial architecture and about better supervision regulation; better corporate governance; about changes in the international economic policy governance and about new international financial system reserve currencies, and although all these things are important, frankly we're still in the middle of a very severe crisis and we have not yet fully resolved this crisis. I think there is a little

bit of a complacency here: for the last couple of months the U.S. and the global stock markets have been going sharply up; commodity prices are up; credit spreads are narrowing; resentment is improving and people are saying the crisis is over. They say, "the recession is over and we're going to go back to potential growth very quickly in the U.S., in other advanced economies and in emerging markets. But when you look at the data, in spite of all this talk about green shoots, I see plenty of yellow weeds. I think the economic data is not as robust in the U.S. and advanced economies. I think the recession may last another six to nine months, rather than being over today. I think that these financial imbalances and the leverage is going to lead to a period of slow economic growth in advanced economies: anaemic and well below potential.

There is a lot of talk about deleveraging, but there is not much deleveraging going on. Today the ratios of households, of financial institutions, of corporates, are still very high. What we are doing is, in part, socialising those private losses; leveraging up the public sector with very large increases in budget deficits in many countries. This will lead to a very large increase in public debts and these large increases in public debt will eventually have to be paid for, either through inflation tax or default, or by raising regular taxes or by making cuts in government spending. So we are creating problems further down the line. I think the recovery is going to be very anaemic for the next couple of years because these imbalances were not resolved.

I also see the risk of a relapse of a double D period, a W-shaped recession. I think oil and commodity prices are rising too fast, too soon. You know, maybe close to 200 dollars per barrel, at a time when the global economy has not yet recovered. Part of this is the result of [inaudible] but part of it is driven by this rush of liquidity, now going into a bubble imparting commodities. By next year, a situation of too high oil prices, budget deficits and concern about medium term fiscal sustainability may lead to increases in real rates. We've seen this pick up in long rates in the US and other countries. I'm concerned that the continued monetisation of the budget deficit is eventually going to lead inflation, which could lead to a perfect storm that will clip the wings of the economic and financial recovery. So I think there are plenty of risks ahead of us and we are not yet out of the woods, we are not yet out of the tunnel. Therefore we still have to emphasise the policy that will lead us out of this crisis in a systemic way and in a sustainable way, before we think about redesigning debt architecture.

Now, once we are out of the crisis, of course, we will need to redesign the architecture and certainly the question of better regulation and supervision is a crucial one. For the last decade or so, at least in the Anglo-Saxon countries, the ideology was one of a self regulation. We discovered that self-regulation means no regulation, with an ideology of relying not on market discipline but on market exuberance. There was no market discipline. I was relying on internal risk management models but, as the previous CEO of Citi said, when the music plays we are going to stand up and dance; nobody

is listening to the risk managers, because they are the party poopers, while the risk takers and those who are making the profits got the upper hand. The reliance on rating agencies caused massive conflicts of interests between those they were supposed to be rating and a reliance on principles; rather than rules of light touch regulation; rather than hard regulation. Every single pillar of Basel II has already kind of failed, even before it was implemented, and that's why we start to think about Basel III. So, we are to completely re-think regulation.

Now the framework is clear: we need the institutions to have more liquidity; to have more capital; to have less leverage; a better risk management; a better compensation incentive and we have to regulate a better global, systemically-important, financial institution. Also we have to avoid regulatory arbitrage by centrally regulating different thrift banks from non-bank financial institutions. In some senses, it doesn't matter whether you call yourself a commercial bank or an investment bank; an insurance company or a finance company; or a hedge fund or private equity; if you borrow short and in liquid days, if you leveraged and if you lend longer and in liquid ways then you should be subject to the same kind of regulatory umbrella, because otherwise there will be derogatory arbitrage that leads to the excessive growth of a non-regulated shadow banking system, which in turn led to the troubles that we are experiencing right now. So that's important, but I think it is also crucial to think about the reform of corporate governance because I think there was massive failure of corporate governance. Regulation can be as good as you want it to be, but we always know there will be forms of regulatory arbitrage, because of the ability of the financial institutions to innovate faster than regulators can regulate. It's always been there. You can close loop holes, but it's going to remain there. I think that this is crisis is as much about corporate governance as about anything else, you know. Finance theory always speaks about the issues of agency: that principals and shareholders in an institution cannot fully monitor the actions of agents, of managers, traders, bankers, and so on, because there is symmetric information. I think that those agency problems are much more severe in financial institutions because, you know, how could even a very sophisticated, bold CEO control the actions of thousands of separate P&Ls; thousands of traders each one of them being bankers with their own P&L. You know, you can have better risk management; you can avoid [inaudible]; you can have better reporting, but there is that fundamental thing. So I think that one problem is really a question of allying remunerations and compensation, to make sure that what has happened for the last period, does not happen again. This essentially means traders and bankers effectively ensuring against a catastrophic event. For six out of seven years there are high revenue, high premium, high profit, high bonuses and in year seven the institution goes bankrupt because of that excess risk taking. So I think incentive compatible remuneration is a fundamental problem. But I think there is a double agency for problems. It's not just that the shareholders were not able to monitor what bankers and traders were doing, because in modern

corporate settings, the shareholders themselves are represented by other kind of agents and institutional investors. The interests of these institutional investors are not necessarily aligned with the underlying shareholders. When Vikram was speaking about standing up when the music is playing, he was not just referring to the internal fight between risk managers and risk takers, but also to the fact that there is market pressure; that the shareholders or decision investor are telling institutions, that "others are more aggressive, others have higher return on equity so you should be more aggressive."

So, then there is a fundamental problem of corporate governance. I'm not sure exactly how we resolve it, but we have to resolve it, because this crisis has been really extremely severe. You know, we've had about 30 trillion dollars of global equity wealth destroyed. In the US, at least 10 trillion dollars of valued homes were destroyed. At the peak in the US, I think, we'll have a least 10 million jobs lost and a further 10 or 15 global fall in incomes. The World Bank talks about 50 million people ending up below the poverty line. The fiscal costs are massive; in the US alone, public debt is going to double and there is going to be an increase of 9 trillion dollars of public debt, which must eventually be paid for. So, a large increase in public debts and deficits all over the world. There will be social and political consequences from them all: the financial cost; the world cost; the income cost; the job cost. The fiscal costs of this financial crisis will absolutely be massive and if we don't create a financial system that is more robust, better regulated and supervised, and if we don't really reform corporate governance, I think there will be a massive backlash against the free market, against market economies, against globalisation, against free trade in the direction of financial protectionism. Some government interventions in the economy are now necessary, because there was a failure of markets, bubble excesses and distorted incentives. Now that intervention of the government may become excessive and distort long-term economic growth. The Central Banks used to be the lenders of last resort; right now the Central Banks are the lenders of first and only resorts, because banks don't lend to each other. Banks don't lend to other non-bank financial institutions and banks have stopped even lending to the real economy: the corporate sector. The U.S. even wants to create a commercial paper facility, because of the breakdown in debt lending to the corporate sector. So that's what has happened: Central Banks have become the lenders of first and only resort; governments and treasuries have become the spenders of first and last resort; and insurers and guarantors and so on of first and last resort. We are going from one extreme of laissez-faire, wild west Anglo-Saxon capitalism, without even prudential regulation supervision, to a massive government intervention in the economy, the like of which we've not seen in decades. As I said, this large increase in budget deficits and in public debt, will eventually lead to increase in real rates. It will crowd out private spending. It will demand increased taxes and there will be a distortion of incentive to save; to invest; and to work, and then a massive disincentive,

because, politically, it is hard to raise taxes and to cut spending, or to get your parliament and congress to do so. To them, it is easier run the printing presses, because nobody is controlling that, and to use the inflation tax. If that were to happen, we will go back to the '70s with high inflation, and all the speculation we had during that decade.

So I think that the challenges are really very, very big. We know what needs to be done, but I fear a certain amount of complacency; of saying the recession is over. The financial crisis is over. When we had the East Asian financial crisis and then the LCTM in 1998, there was a moment when people said, "we have to change the system; we have to have better reforms and so on." Then, that momentum for change and true reform fizzled away. I think if we miss the boat that time around and then there is another asset and credit bubble, everything is going to be even more virulent, even more disruptive and even more of a threat to globalisation, free trade, and the market economy. The time has come to change the system once and for all, to make a stable global financial system; to make the financial system more stable and more sustainable. During this boom and bust, things have occurred that were supposed to occur only once every thousand years now, but now they occur every few years, both in advanced economies and emerging markets. These are asset and credit bubbles and the damage that they cause, when the bubble is followed by a bust and the crash is becoming more severe, more virulent and more dramatic. The financial economic costs are becoming more severe, so we really have to change the global financial system to make it more stable.

T. Sebastian:

Nouriel Roubini. Thank you very much indeed. This better regulation that you and the other panellist are calling for, you don't sound very optimistic that you are going to get it.

N. Roubini:

It depends, you know, on the political willingness to do the right thing this time around. I think people need to realise that if we don't do it right this time around then the consequences are going to be really very, very severe. Maybe the extent of this crisis is going to lead to more of a consensus to do it and, as I said, this is not just a question of regulation supervision, because there is always financial innovation ahead of what regulatory actions. I think that they really have to change the system of corporate governance to make sure that it is consistent with long term shareholder value maximisation. The excessive risk-taking debt part of it is as important as doing the improved regulation and supervision.

T. Sebastian:

Okay, thank you very much indeed. Now we are going to here from you, the audience. We are going to put a question up on the screen and ask you to vote on it. Let me just explain to you how the voting machines work. You need to turn them on which means pressing the green button. Can we have the question up on the screen please? Yeah, there it is. Do you believe that the global financial architecture will be the same after the crisis as it was before? If you want to vote for that proposition, press Button 1 which is the Yes button. If you want to vote against it press Button 2 which is the No button, and would you please do that now. I am told you only have to press once and we should have the result for you in the next minute. I am told the technology will deliver an accurate result so we should have that for you very shortly. All right, 25% think that the financial architecture will remain the same after the crisis and 75% don't. Alexei Kudrin, do you think the faith of the audience in the changes that they see happening is—

From the hall:

I think, this is a perfectly logical response, as everyone present here is affected by the crisis himself. Because this is business, this is government, and none is ready to put up with it. Therefore, I think everyone is looking forward to changes.

T. Sebastian:

The 25 percent doubted, that is quite a lot of scepticism, how do you handle that?

From the hall:

This is a pretty reasonable scepticism. It is clear that not everyone is affected by crisis that deep.

T. Sebastian:

So both positions are logical then.

T. Sebastian:

Could be excused for having your cake and eating it. Gertrude Tumpel-Gugerell, your view on that healthy scepticism?

G. Tumpel-Gugerell:

I rely on the 75% as a support for reform I think. It's always important to be realistic, but I think we also need public support to get the reforms done because there is always vested interest against it. I think it is important to have this public awareness about the need for reform.

T. Sebastian:

Vikram Pandit, were you encouraged by the vote?

V. Pandit:

Well I think the people in general feel there will be a reform. The question is what kind? And that's really the debate that we are ensuing here. There's no question we're going to live in different financial market with different regulation and I hope even the 25% understand that. I hope their scepticism is more about what kind rather than "If". I think the "If" is a foregone certainty.

T. Sebastian:

And you, as a banker, are you going to vote for tighter regulation? I'm voting for a bigger fence around you isn't it?

V. Pandit:

I would vote for better governance, better regulation and a very active capital management system for all financial institutions around the world.

T. Sebastian:

Joaquin Almunia.

J. Almunia: I would like the same result when this question will be put forward to the Ministers of Finance [inaudible] council next week or at next year's meeting with Alexei Kudrin will be there in Trieste in Italy in a few days. I hope they will say also yes, but not only 75% – 99%, I hope.

T. Sebastian:

What do you think?

J. Almunia:

I am always optimistic.

T. Sebastian:

In the middle of the teeth of a crisis. John Lipsky.

J. Lipsky:

Well, I always thought that in an election 75% is a landslide but I think it was mentioned before; the road map for reform that is laid out first in the Washington summit, reviewed in the London summit and reviewed again in the Pittsburgh summit was complete and concrete. So it is not just vacuous words but there is a relatively clear road map. You said it before, political will, will be crucial. It seems to me, 75% optimism among a very well informed audience is a good start.

T. Sebastian:

Andrei Kostin, how would you have voted in this?

I think, even more than 75% of those present are looking forward to reforms and changes connected therewith. Scepticism is there because we cannot imagine this new architecture as yet, for which we have to vote, and this results in a vigilance about the way it is going to be attained, the way we can do it, especially when it concerns creation of a new global, supranational order.

T. Sebastian:

Nouriel Roubini?

N. Roubini:

Well, I think that is some scepticism. I think that reform is desirable, but if you look for the last twenty-thirty years, you see a series of financial crises both in emerging market economies and in advanced economies. You have asset bubbles, you see systemic corporate crises; you see sudden direct crises. A lot of them have become more virulent. You can count fifty or sixty systemic banking crises over the last thirty years alone. And the fiscal cost of cleaning up the mess was between five and thirty percent of GDP. So every time something happens, people say: "we'll reform, we'll clean up, we'll better the system". But that there are some fundamental problems regarding the instability of market incentives. The fact that [inaudible] in the financial system that live over and over again to, this things happening over and over again, so we believe, this is gonna be the last, I think, it will be delusion not to think so.

T. Sebastian:

So do we have to get used to a much more uncertain world financially. Is that your proposition?

N. Roubini:

We cannot get used to this, because these things are becoming much more severe and virulent. This one, I think we agree, is the worse one we've had since the Great Depression. If we don't really

tackle them in a serious way then capital is becoming increasingly globalised. The transmission mechanism of shocks internationally; trade; financial flows to credit; commodities; currencies; confidence are becoming massive. Sub prime problems in Arizona, California have led to a global financial crisis. Of course, it was not just the sub prime mortgage problem. There was a larger, more generalised problem: the credit bubble and housing bubbles in many different countries, but this is the extent to which we all believe in the benefits of a global economy. But there are significant issues in the management of the global economy, trade, financial flows global economic which we cannot address and which will lead to a severe backlash against the market.

T. Sebastian:

OK, on that note of warning. I'm going to bring the session to a close. Thank you very much. Thank you, participants. Thank you, the audience. Thank you very much, have a nice day, and goodbye.