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THE FUTURE OF RESERVE CURRENCIES

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Description:

The majority of foreign countries, including Russia, hold their international reserves in foreign currencies. How safe are those reserves? Responsible monetary policy of countries issuing reserve currencies. The role and prospects of reserve currencies. Can the Rouble become a reserve currency?

Moderator:

Roland Nash, Head of Research, Renaissance Capital

- **Arkady Dvorkovich**, Aide to the President of the Russian Federation
- **Gertrude Tumpel-Gugerell**, Member of the Executive Board, European Central Bank
- **John Lipsky**, First Deputy Managing Director, IMF
- **Stephen Graham Elliot**, Senior Vice-Chairman, The Bank of New York Mellon
- **Helmut Reisen**, Head of Research, OECD Development Centre
- **Ousmene Jacques Mandeng**, Head of Public Sector Ashmore Investment Management Limited

Verbatim:**R. Nash:**

Good afternoon, ladies and gentlemen and welcome to our afternoon session, The Future of Reserve Currencies. This is obviously a subject which has become far more important over the last several months, and in particular, we have heard in the last couple of days how much of a focus is being given on the subject by the Russian Federation and internationally. We heard from President Medvedev yesterday in his plenary session that he thought that there should be an emergence of new reserve currencies, and we have heard similar statements from various officials over the course of the last two days, and I think in many ways, the very fact that we are discussing this at such a high level calls into question the long term viability of the US Dollar as the world's reserve currency. Because if there is one thing that defines a reserve currency, it's confidence in that currency, it's confidence in the economy that issues the currency to continue to be strong, it's confidence in the financial institution of that country to continue to be strong, it's confidence in the legal system and it's confidence in the long term financial viability of the government of that country. I think it is very interesting that we are sitting here with this illustrious panel in Moscow just two years after the biggest boom in financial history. 27 trillion Dollars later, after the collapse in the world equity market - when two years ago the dominant financial set of institutions in the

world and the US were generating over one-third of all US profits - we're now sitting in Moscow two years later discussing the future of the reserve currency. Now, I have a wonderful panel to discuss this question, with CVs far more illustrious than mine, so what I would like to do is very briefly introduce them, and then get on with the discussion of the topic. On my right, I have Arkady Dvorkovich who is Head of the Expert Directors of the President of the Russian Federation and despite Arkady's youthful good looks he has been a major adviser to the Russian president in Russia for most of the last 15 years really since the break of the Soviet Union. On his right, we have Dr. Gertrude Tumpel-Gugerell, who is a member of the Executive Board of the ECB and I think can provide a great perspective on the future of the Euro within that. To her right, we have Ousmene Mandeng, who is the Head of Public Sector Investments Advisory at Ashmore Group. Throughout his career has been looking exactly at this question of the future of reserve currencies, first with the IMF and later at Ashmore. Ashmore is one of the largest holders of private holders and traders of currency in the world. To my left, I have John Lipsky, who is the first Deputy Director of the IMF. Mr Lipsky has really been front and centre throughout the financial crisis over the last couple of years. To his left, we have Stephen Elliot, who is the Senior Vice Chairman of the bank of New York Mellon, as I am sure most people in this room know the bank of New York was the first bank in New York. It really was one of the starters of the financial growth within the US. The bank of New York now has 800 billion Dollars invested throughout 48 countries, so it's a real global perspective. And then finally, to his left, we have Dr. Helmut Reisen, who is the Head of Research of the Development OECD Centre, and has been writing and speaking about the emergence of India and China, and the impact of that has in the world economy for most of the last 20 years.

What I would like to do is begin by asking Dr Dvorkovich: what do you believe the implications of the financial crisis on the future of reserve currencies and in particular, what do you think it means for Russia?

A. Dvorkovich:

Thank you Ron. Good afternoon ladies and gentlemen. First of all, I think we've had a very good forum up to now and I hope we will continue with these round of sessions as well. On the question of implications of the financial crisis for reserve currencies, I believe that, first of all, we do not know this answer yet. We can only discuss what may happen on the results of the crisis. There are many risks still involved in their current and future developments. First of all, everyone has started to look at what is going on with the US Dollar. Some people, who were close to panic when the Dollar started to fall, had forecasted it could go down to \$2 per Euro. Remember at some point it was close to 0.8, but it was a different time and this shows that relativity is quite big. And the crisis will increase volatility, and that is the main implication. Increased full activity implies that the risks

that all market participants take when they use Dollar instruments are higher. Everyone saw this, because everyone was an oil company or a bank - or just an individual: a household wants to reduce its own risks and tries to diversify its holdings and its transactions among various currencies. In Russia, where the people are in the midst of a crisis, there was a fight between Dollar and Euro and the Euro holdings were increased substantially. If the central bank of Russia did the same thing, we could increase share of Euro assets in its basket of international reserves.

Also, we should not forget that we have some other reserve currencies as well, not as important as Dollar and Euro, but still we have Yen, we have British Pound, we have Swiss Frank, they are not used so widely as the first two, but still. Also there is a clear trend right now given that we still have growth in China, in India and some other countries, while we have the recession in other countries. We have clear strengthening in new currencies like Yuan and some others, and we also see that there are small agreements between China and other countries to reduce risks and basically, this nature or trend was created by the crisis to increase the role of other currencies and to reduce the role of Dollar. It is not artificial, it is a trend that emerged as a result of the latest development and we have already had a first lesson from the crisis. The diversification of the reserve currencies can bring higher stability into the system and it is not about naming this currency, it is about the competitive advantage of one or another currency.

R. Nash:

Thank you Arkadiy. Mr Lipsky, I apologise in advance for doing this, but I want to, if I could, read back a quote that you gave in September, I think last year. I am an economist as well and everything has changed overtime and perhaps the quote is less appropriate now than it was, but the quote was, "Fiscal policy is broadly appropriate across the advanced economies, but room for manoeuvre is limited given the need for medium term fiscal consolidation in many of these countries." In your opinion, has the financial crisis and in particular, the US reaction to it, damaged the position of the Dollar as the world's dominant reserve currency?

J. Lipsky:

Well, let us take a step back - obviously that was before the rather dramatic events of September that produced a historic contraction in global economies that occurred in the fourth quarter of last year and the first quarter of this year, that justified an unprecedented and coordinated fiscal and monetary policy response. That being said, (and hopefully that response has been adequate) to limit the downside risk, or the risk of a really serious and extended downturn in the global economy is going to help set the stage for a returned global growth in the coming quarters. It will leave a legacy, by the way as I said, of re-establishing confidence in medium-term fiscal sustainability and in all the advanced economies. Certainly the legacy of this period will be additions, in many cases

substantial additions, to public debt. Nonetheless, the main medium-term challenge to fiscal sustainability comes from demographics and from entitlement programs. Promises the governments in the advanced economies have made to their citizens, with regard to health care and retirement benefits that will have to be reconciled with medium-term fiscal sustainability, so over the next 10 years basically, all the advanced economies are going to be facing these challenges.

Let us come back to the issue of reserves, which was what you asked. In the near term, and I suspect, what you are getting at, they are going to think about what is the role of a reserve, and what is required for it to become a reserve currency. First and foremost is the combination of liquidity plus confidence in the currency as a store of value. In the near term, there is a possibility in the post-crisis environment of a risk of a scramble for countries to acquire additional reserves as a means of self-insurance, which is a potential risk to the balanced recovery of the global economy. Now, the Dollar currently and for many years has constituted about 60-70% of global reserves; it has not changed all that much, but in the long run, using any sovereign currency as the reserve currency or a reserve currency creates what economists call a Triffin dilemma. In other words, to provide adequate liquidity requires the reserve currency to run a deficit to add to liquidity. If we judge from traditional rules of thumb about what is the normal or the reasonable level of reserve holdings, a typical guide is either to use import or trade invoicing and the currency of invoicing, and more recently, taking into account capital transactions. Actually, from that point of view, currently the Dollar reserve holding is not out of the line from those traditional measures. And, if we are thinking about alternatives, we have to think about what other currency might fulfil in a better way the role that the Dollar, or other currency such as the Euro, is fulfilling now.

I suspect you want to talk later about the things like the Special Drawing Right as a potential reserve currency, but suffice to say, what your question suggests - will the aftermath of the crisis damage the credibility of the Dollar as a reserve currency - and I think it will depend on the success of the policy of the United States authorities to restore the US economy to health, to sustain its recent relative low inflation performance and to create or enhance medium term fiscal sustainability. But this is a challenge, as I said at the outset, faced by all the major advanced economies.

R. Nash:

Thank you very much. Dr Tumpel-Gugerell, what do you think about the policies that are being followed by the US? Do you think that they will allow the US economy to emerge in a sort of position where the Dollar will remain a reserve currency? What was the view of the ECB on the policies that are being followed at the moment and the aftermath of the financial crisis?

G. Tumpel-Gugerell:

Thank you. I would not like to comment on the US policies or the Dollar, but rather describe how the European Central Bank sees the development of holding foreign reserves and choice of currencies. The reserve currency holding seems to be a very technical matter for reserve managers, but it can have a big impact on the monetary system of course, and therefore, I would like to focus on three remarks. First of all on how we see the use of the Euro in foreign reserves, also what we see as a development during the past ten years, and maybe also some general aspects that might influence the choice of the reserve currencies.

We should keep in mind the international use of currency is a market-driven process. It is determined by independent decisions of private agents and public institutions. The European Central Bank has a neutral position on such matters, so we neither promote nor hinder, of course the international use of the Euro. History has also shown that the currency composition of global fund exchange reserves evolves very gradually over a long period of time and can have a lot of initiating in these considerations. What we see in the data for the last ten years (and I think I have also brought some slides, I do not know how they are activated, but maybe someone might help me) and the only source of data we have for these are the IMF data and we should keep in mind we only know about the reserve composition of two sets of world currency reserves, because for the remaining set, we do not know the composition.

R. Nash:

Maybe I can just ask if, do we have those slides available anywhere? Is it possible to put them up? No? Thank you.

G. Tumpel-Gugerell:

Therefore, I think one of the important steps to get transparency would be to get full reporting of currency reserve data to the IMF, because this would help us to much better understand and interpret also the developments, and I would say the Central Bank of Russia has been exemplary in this context because they are now publishing a composition of currency holdings. In the annual report, I think this was a very important step towards greater transparency, and if we look at the IMF data, keeping in mind that these are only two sets of the reserves, we see that the share of the Euro has risen from around 18% at the time when the Euro was created, to 25% in 2003. And we also have to take into account devaluation effects, but since then the share of the Euro has remained more or less stable at around 24-25% and during the intensification of the financial crisis this has not changed so much. The share of the Euro has slightly gone up, but only more or less by one percentage point. Of course, this process could have also been influenced by emerging market

Central Banks which have intervened to defend their currencies during the second half of 2008, and have partly sold reserves and assets.

So what in principle are the requirements for a currency to become a reserve currency? First of all, price stability and the tax and liquidity of the financial markets and capital markets, and I think in this respect, the Euro has developed very well. I think it is a very liquid financial market now (I would also have a chart on this, but maybe we will see them in a minute). But obviously more needs to be done also to become an international widely-used reserve currency, and if you look back over the last 30 years, it was obviously a very good choice to go with the Dollar because the Dollar was a kind of hedge for the portfolio investors, and this was the choice for many central banks. But over time, we have also seen that currency composition changes have occurred because we have seen a higher diversification.

In Russia, the share of the Euro has grown for the first time above that of the Dollar and it currently stands at 47% and we have to keep in mind that also this strategy in Russia was preceded by introducing the currency basket by the Central Bank of Russia. This is used as a reference for the exchange rate policy. The process has started, gradually, three years ago. I think these are all long term considerations which should be kept in mind and have to be linked to the issues of trade financing and international exchange of economic activities and investment flows. Therefore, I think currency compositions change gradually only but they do change.

R. Nash:

Thank you very much indeed and I hope we'll be able to get those slides available at the end. Mr. Elliot, maybe I could ask you a similar sort of question. Presumably, the future of reserve currencies will depend on the impact of the financial crisis and the policies that have followed as a result of it. What do you think is the future of reserve currencies, given the size and magnitude of the global financial crisis and the US and Europe's reaction to it?

S. G. Elliot:

Thank you Roland. And just to expand on some of the comments of my fellow colleagues here on the panel, the one additional item that I bring up would be to look at what happen last fall what impact the financial crisis had on the reserve. A key test of EU reserve currency is what happens in a financial crisis. I think that's the kind of the ultimate test. Here we did see the flight to the US Dollar, obviously it strengthened significantly during that period, and speaking as a US bank, what we saw was a huge flight of deposits to US financial institutions. For example our deposits in the 30-day period around the Lehman situation from the middle of September to the middle of October, our deposits went up by 50% in the 30-day period. And I would put that out as a fact statement with respect to what happens in a financial crisis. You're going to go to the strongest the reserve

currency.

Obviously as the crisis has ebbed and flowed here, we were seeing exactly what I think you would see. Dollar weakness, if you look in terms of what's happening to the deposits at the Bank of York, Milan, now come back to the pre-Lehman-day level of deposits. It took like five months to get there but we're now back to square one, with respect to where we were previously.

With respect to the second part of your question, reserve currency is something that I think you 'lose' as opposed to, say, someone leapfrogging ahead of you and if you look in terms of the US Dollar as a reserve currency, the US is to lose. The US loses if we can't maintain good discipline around both monetary and fiscal policy, if we can't keep inflation, hopefully, in that 2% zone over time. If the US is not able to do that then it's ours to 'lose' to other countries.

R. Nash:

Thank you very much indeed. Dr. Mandeng, I know that you've just returned from China and talking about countries that may eventually leapfrog the US as a potential reserve currency. I wonder if you could elaborate on what are the potential alternative currencies to the Dollar and what sort of time frame we might be looking at to see them becoming at least more importance as a reserve currency.

O. J. Mandeng:

OK. Thanks Ron. Maybe before answering the question, I would like to take a step back and see where we are. First of all I have always found it surprising how late we are addressing the international monetary implication of this crisis. I mean I think monetary implications have been at the core of the crisis and yet it's only now that it's really gaining that the debate around is gaining momentum. And I think key has been, among others, thanks to the proposers and by Russia and also by China and this panel now, the fact that we are debating this is a very good sign. But I think it's also useful maybe to keep a little bit of perspective. The alternatives for the Dollar: there aren't any today. But it doesn't mean that we should not start thinking about possible alternatives. Not so much to substitute the Dollar anytime soon but to provide complementary regimes that will allow us to engineer a gradual and orderly exit from, what is today, an excessive reliance on the Dollar.

Mr. Elliot mentioned and rightly so that there was a flight to US assets following the collapse of Lehman Brothers. But that in itself, you could argue, is precisely the complication of relying or having to rely on a national currency. The fact is the Fed does not subordinate its domestic policy objectives to the needs of the international economy and that problem has been revealed with the Lehman collapse and the very rapid increase and exchange rate volatility that we have seen. Had the Fed had a global view about its policy objectives, it would have accommodated what has been a

Dollar shortage effectively. And I think that was a good reminder that the reliance on national currency poses a fundamental problem. Mr. Lipsky mentioned as much and I think that is a key issue of what the limitations of the current system are. And I think we should think about the limitation of the current system before we try to formulate possible alternatives. It's an oddity that on the one hand we have an increasing multi-polar international economy, an increasing commercial diversification and yet on the other hand we have a unique concentration in terms of monetary transactions. And that in itself probably creates a lot of the instability and the problems that may have led to the crisis in the first place.

In terms of alternatives, I think again it's about looking for a regime that can complement the Dollar over the medium-term. And I think by fall here we should look not so much at the Euro, not so much at the traditional currency but we should look, above all, at the emerging market currency. The fact is emerging economies today represent already of one-third of world output in terms of market prices. And yet their currency is absolute no use in internationally monetary transactions. Again it's a historic oddity. Normally the importance of countries makes their currencies be used in international transactions, and that isn't the case today.

So I think in terms of alternatives we should look at new currencies outside the main currencies we are currently looking at. And I think we have a new international government forum which is the G20. We have key emerging markets in that forum. This is a platform for policy dialogue. Those are the countries I think we should be looking at if we wanted to identify new reserve currencies. Again the time frame, I think we should start today. I think the crisis has shown that we should not continue to rely on very few national currencies and I think I can see this being a gradual process over the next years, decades. Let's not forget the emerging markets will represent about 50% of world output within the next 10 to 12 years. And it would be extremely unlikely that by that time we should not also be using their currencies more. So the time frame is one that should start today and I think it will accelerate and materialise over the next 5 to 10 years at max.

R. Nash:

Thank you very much. I'd like to ask a very similar question to Dr. Risen, given his expertise. The rise of India, China and Russia: what do you think the implications of that is for reserve currencies globally. Do you agree with Dr. Mandeng?

H. Risen:

Yes, I actually sympathise a lot with what I just heard. I think it's also in the line of the UN Committee of Experts that has been headed by Joe Stiglitz, which found that the current system is wanting. Any single currency reserve system is by nature deflationary, unstable and unequal

because it amounts to transfers by developing countries to the United States, who issues the currency. Now I think Renaissance Capital is actually a very nice example of what is going on in the world. It's a Russian investment firm that invests very heavily in Africa. And we see a growing role of so called south-south flows, non-OECD capital flows, and a growing role of in-trade as you just mentioned, Mr. Mandeng.

We have a projection that by the year 2015, China will surpass the United States in purchasing power term, the GDP that is, and that amounts actually only to a re-emergence because it was the largest world economy until 1870. Currency empires, if you have a fast look at history, come and go. We have had over the last two millenniums, about six to seven reserve currencies, the Chinese Liang, the Greek Drachma, the Roman Dinar and so on, and the last one was Pound Sterling, which was dethroned by the US Dollar in 1945.

If you look at that last example as a guide to history, you might be tempted to say the Renminbi will be the global reserve currency by 2050 - because of the United Kingdom, it lost its supremacy in 1870. It switched from net credit up to net debt position just after the world war, because of the world war. And it wasn't until 1945 that the US Dollar dethroned the Pound Sterling, partly for geo-political reasons because a lot of colonies held on to the Pound Sterling. That might be happening now as well, for example, Saudi Arabia as an important oil producer, might hold on to the Dollar. But more generally I think that these shifts that we are witnessing these days will probably lead to a new system. I would hope that it would not lead to another single currency system but, along the lines of President Medvedev - to extend the Special Drawing Rights system, which I think we can engage a bit into whether that makes sense or not.

I have written, just to end on this note, that the Dollar is like the English language. These days it's a lingua franca and the Special Drawing Rights these days is not more than Esperanto. We have to see now how to get that Esperanto more widespread before we can seriously think in operational terms of the Special Drawing Right as something extended. Special Drawing Right is something that might replace a Dollar.

R. Nash:

I would like to thank you very much. I would like to ask both Mr. Dvorkovich and Mr. Lipsky to answer some of these points that have been made. And in particular - what can be a future reserve currency? To Mr. Dvorkovich, is it ever possible that the rouble will become a reserve currency, and what needs to be done to get there or move in that direction? And secondly to Mr Lipsky, whether the SDR is in the position to become an alternative to the Dollar as a reserve currency.

A. Dvorkovich:

Thank you. First of all I think that to have an efficient reserve currency you need to hedge against the risks that we all have, we need negative correlation. We need to save in something that is negatively correlated with the price of your own assets.

For Russia, it appears that since as a rule, not always but frequently, Dollar or vice versa, all prices are poised to be correlated to the US Dollar. It is more rational to have at least some part of reserves not in Dollars, but in other currency, in another instrument. Otherwise you cannot reach the effect in terms of hedging of your risks.

For any country the choice can be different depending on insulation to other countries and other issues of reserve currencies of course.

Alternatively you can have a basket, since it smoothes some of the fluctuations plus it can force countries that issue reserve currencies in the basket to coordinate more, to talk with each other about the policies to consult on the possible implications of national policy measures. Whether it's increasing the budget deficit or interest rate policies, which can by itself bring more stability. The consultations, coordination and dialogue can bring better understanding of the situation in each particular country and this can create a more stable international monetary environment, which I believe is very important for the future of the global economy.

This brings us to the idea of for example SDR being a possible reserve currency in particular taking into account that as mentioned to have reserves in some currency instruments, you need to have sufficient amount of these instruments and if countries try to reduce deficits right now to preserve a long term fiscal sustainability you will need someone to issue a sufficient amount of interest. Clearly given the various needs of the world including insurance to get the crisis including development date, the issue of such instruments by international financial institutions is one of the possibilities whether it's the IMF or World Bank or some other institutions and it will be natural to issue these instruments not in the national currency of some country but denominated in the basket of currencies.

What this basket should include should depend on the weight of the countries and the global economy as was mentioned and clearly at some point maybe already now this basket should include Yuan and some other currencies given the weight that these countries have. The only restriction here is currency regime of course and the fact that Yuan is not convertible creates some concerns if this currency will be in the basket so maybe there should be some transition period when you would want to do this.

But we should be looking at this. We should discuss this and at some point this would be a natural solution. Also given that even in this case, we still depend on the decisions of national government, the governments maybe we can hedge a little bit more by including gold into the basket. Create additional stable elements in the basket of instruments and gold prices are usually negative

correlated with oil prices and this can bring additional stability to the system. So we believe that this kind of trend can create a better coordination, more subordination of national policies to international needs and probably we can think in parallel also about agreement on centralised management of natural resources by International Monetary Fund. It will create again an additional degree of coordination among countries.

Whether the rouble can become a reserve currency depends on its strength not in terms of numbers but its strength in terms of macro-economic stability in Russia, convenience to use the rouble as an instrument for trade and investment transactions. Clearly our main trade partners around us, our neighbours are using the rouble more and more in their trade with us. Also the crisis lead to the creation of an anti crisis fund which will be soon inaugurated and this creates more demand even more demand for this instrument. So it will be a natural trend, when the rouble will become an important reserve currency is not clear. So it will depend on our own policies whether it will be successful or not. We cannot as the president said yesterday sign the rouble as a reserve currency, that is impossible. But we believe that we all can gain not only Russia but our neighbours can gain from the rouble going into this direction. So this is our overall outlook.

R. Nash:

Thank you. Mr. Lipsky.

J. Lipsky:

Thank you. Look those were very good remarks and I think very clarifying. I'll just add a few. One just to note something of importance, in general I think it's certainly true in the sense that the Federal Reserve doesn't target the Dollar exchange rate. It views itself as operating a floating exchange rate. Nonetheless during the crisis and as you heard during a period of dramatic increase of Dollar demand, the Fed as you know entered into a historically unprecedented series of currency swaps with foreign central banks in some cases in unlimited amounts. So they stood willing to supply international markets with essentially unlimited Dollar liquidity. I'm sure if they had not done that the financial strains and crisis would have been much worse.

But then simply to agree with what we just heard about what constitutes the kind of qualities that are necessary to create reserve currencies are for currencies to evolve into a reserve status. As I mentioned earlier it requires a liquid, strong, credible, stable financial system; requires credibility of economic policies and characteristics such as convertibility. These tend to evolve naturally over time and certainly should be expected as the global economy evolves, as we continue to see emerging markets evolve in the way that we've already discussed, it would be natural to see a diversification of reserve holdings but as I think my description suggest and as you already heard mentioned those evolutions in general - not always, but in general tend to move relatively slowly.

But certainly we do not have a single currency, a single reserve currency system today. So the Dollar represents only 60-70% of reserves. We have a multiple reserve currency system, informal of course, not managed in any direct sense. But then let's turn to the issue of could we have a created, managed reserve system? And that in recent times has focused on the question of whether the SDR, the Special Drawing Rights could become a reserve currency. Right now it actually is a reserve asset in that those institutions that are credited to hold SDRs to participate in the SDR program or account as we call it, the IMF, the SDR is a reserve asset by definition. But it is a very unusual one. It is not liquid. It is not able to be held by private individuals. It is usable only under very constrained circumstances. So although you're probably aware that there was an agreement at the London Leader Summit to allocate an additional \$250 billion worth of SDRs, and a formal proposal is likely to come before our executive board in the next month or so for that action, that won't fundamentally change the nature of the SDR today.

Now what would it take to turn the SDR into a real reserve asset in the way that we think about it. Well right now the SDR is defined as a basket of currencies. In that sense it's a bit like the old ECU that preceded the Euro. If you hold an SDR effectively you would be holding a basket of currencies. So an individual can recreate that hedging strategy simply by using the using the commercial markets and creating their own hedging basket. So in a sense if you wanted to hold the SDRs, the market could create them, could create private SDRs as opposed to official SDRs. So we would have to see if the demand would emerge. To move to a true reserve currency status for an international currency caught if it be the SDR or any other is actually when you think about it a big step, because it would have to be de-linked from a basket of currency and becomes a currency in its own right, issued by an international authority that would have qualities like a central bank. It would imply granting or transferring seigniorage from in current national central banks or in the case of the ECB, the European Union, the Euro areas, central bank to an international institution. It would require probably granting lender of last resort authority to that institution. Now we may all think that in the long run that's a good idea and if we have faith in the ability to effectively manage such an institution and its monetary policies, there are many, many attractions in the long run to such an outcome. But what I'm trying to signal now is it is not a quick short or easy decision. It's really a rather large one that would be quite revolutionary.

R. Nash:

Thank you. I want to open up the floor to questions right now but whilst you're thinking about those questions, I also want to give the opportunity to the panel to maybe answer some of the points that were made. I see Dr. Reisen would like to make a comment.

H. Reisen:

I would just like to come on whether this requires a large step or whether it requires several small steps. I think one can take a constructive line. First of all, on the <inaudible> whom you certainly know, who has been IMF director; he suggested that those countries that feel uncomfortable with the current level of Dollars that they hold in their reserves get the opportunity of a substitution account where these Dollars are transferred into STRs. And actually many central banks are starting to mimic the STRs. When you say Mr Adolf Kovic that Russia has diversified its monies in its reserves, it is actually already mimicking it. So that's one concrete step. Another step would be to redefine the STR. The STR is currently based on four monies and it is certainly good for purposes of stabilisation to introduce a more real component that means to peg it to some raw commodities. You can do that fairly easily by taking three already known convertible currencies; namely, the Canadian Dollar, the Australian Dollar and the Norwegian Krone. Here you would have currencies that actually mimic to a large extent; gold prices, iron ore prices and oil prices and therefore you would have already another very specific step to improve the characteristics of the STR. A further step then would be to bring in the major emerging market currencies to the extent that they have turned themselves convertible. I think that is a prerequisite otherwise it wouldn't work. So, you would have several specific steps that avoid revolution but are rather an evolution that corresponds very much to what is going on in the world economy.

R. Nash:

Thank. Mr Lipsky do you...

J. Lipsky:

That's absolutely correct. It wouldn't create a true currency, as I would describe, but certainly those are possible steps. Of course, the substitution account has been proposed in the past, an issue to make it operational – and this is the substitution account is an idea that an account or a facility that would allow official institutions to trade their, for example in that case, Dollars for STRs. Ultimately, someone has to take the exchange risk; someone has to be willing to take the cost of the exchange risk in that transaction. And when it was seriously proposed in the 1970s, why it never actually was consummated, if you will, or formally adopted, was exactly that no one was willing to accept the implied exchange risk in such an account but the steps that you described are certainly plausible and imaginable in the foreseeable future but again, would not go all the way to actually creating a reserve – a real currency, for example, equivalent to a national currency.

R. Nash:

Mr. Mandeng, last question for you.

O. Mandeng:

OK. I'd like to add on the STR. The STR has been around for a long time since '69 and if you read the article of agreement the idea was the STR will become the dominant reserve asset and it never has. And I think it never has because it's intimately intertwined of course with the institutional arrangement of the IMF itself and the difficulty of a proper allocation and then distribution. The mere fact that the G20 committed to it in early April and yet, even until today, we haven't had this allocation shows the difficulty in dealing with STR as reserve asset, I think going forward. So I wouldn't put too much faith into the STR for that reason. And I think another key aspect that is worth reminding, there are not many currencies today that come close to – anywhere close to the Dollar or the euro for that matter, but it's also because central banks are not using these currencies. And I think it's important to point out that the allocation of international reserves makes certain currencies attractive as reserve currencies. If China decides not to hold anymore US treasuries, then the US treasury market would collapse and with that the Dollar. So, China has become, kind of, the margin of stability to making US treasuries attractive reserve assets in the first place. That same stability can be granted to other reserve assets if China, Russia were to decide to hold Brazilian assets today, these assets, these currencies, will become more attractive currencies and will eventually qualify as reserve assets. So reserve currency is also endogenous to central bank allocation behaviour. I think that's very important and I think it gives us today the possibility to embark on currency diversification and seek a multiple currency regime rather than what we have at the moment.

R. Nash:

Dr. Mandeng, I can't resist following up with the question to you – if it's inevitable that other reserve currencies emerge over time then surely the market is going to start arbitraging that ahead of time and whatever design we'd like to have for a reserve currency will become irrelevant because the market will have already made that move in the first place. And for the question of the Chinese or for that matter, the Russians are holding reserves in Dollars or in treasuries, if you know that that process is going to happen then presumably you're going to try and move ahead of this. Well, how do you react to that that the market will get there first?

O. Mandeng:

Yes, can the market really go ahead here or is it something where the market – or maybe where the official sector have to lead this process and I think this is an opportunity for the official sector to lead and where the market may actually have to follow. It is only today the official sector that, I think, has the possibility to create minimum conditions to allow certain currencies to eventually

emerge as reserve currencies. Here the official sector, I think, has the opportunity to lead and it is the market that would actually follow and then accommodate those rules.

R. Nash:

Thank you. Finally, I would like to open up to questions from the floor. Please in the front row here.

S. Guriev:

Thank you Mr Chairman. Sergei Guriev from the Russian Academy of Science. I think you have here some kind of internal contradiction in our debate. From one hand you said that the market should decide, what will be the next basket or new reserve currencies. From the other side we are speculating about what should be the requirements or objective criteria for this new currency. Of course, the market will decide but in this market, there are some major players. These major players are central banks and in fact if central banks come to some kind of consensus this will be a decision. The problem for this consensus is that among all the monitors of authorities or G20, which are trying to elaborate some criteria for the creation of the reserve currency, those who create reserve currency are not really ready to be under any international regulation. If you look for a Dollar creation just now, you'll be seeing that as a mathematician says, it's just the regime with acceleration. The creation of Dollars is going up exponentially during the last couple of months. In the present situation, I don't think that the demand for the Dollar will go up at the same rate which means that the imbalance between Dollar creation, supply of Dollars and demand of Dollars will continue to deteriorate. So, it means that if this Dollar-based system is going to the regime with acceleration, it is going to collapse. And we are going to the situation of the competition between various currencies and this creates turbulence which everybody wants to avoid. To my mind, we should think about two scenarios; the first scenario is a turbulent scenario of competition between various currencies. Nobody understands how it will go on. The second scenario is somehow to divide the worldwide financial system into sectors. Those sectors which could be regulated in terms of Basel standards, in terms of derivatives, in terms of criteria from money creation of reserve currencies and another sector which is out of regulation. Of course it is not easy to create such a construction but if you don't do this we should continue the international monetary turbulence regime which is going to create more and more chaos in the financial system. So, my suggestion is perhaps we should finally come to the decision, if we want to avoid financial pyramids and financial turbulence; we need somehow to elaborate the system where economic financial agents including the central banks which create reserve currencies should allow international regulation and those who don't allow international regulation should be out of this system. And to my mind, the only criteria for the reserve currency, if you want the stable regime, is the positive balance of

payments; those economies which have positive balance of payments are clear candidates for the new reserve currency and of course, convertibility. Thank you.

R. Nash:

I would like to ask the two representatives of official bodies to react to this first of all...

A. Dvorkovich:

First of all, we decided in G20, all the countries decided in the G20 that nobody will be out of regulation. It was a French proposal that was approved by the leaders. Everyone will be regulated maybe unfortunately but that's life. The second point is on the last words you said, that balance of payments tend to change, one day its positive, next day its negative. The system is too unstable. The third point is regarding Dollar creation. Actually, it's base money that is growing exponentially as far as overall money supply is concerned, the rate of increase is higher than before, it was like 6% on average before, right now it's 9% but it's not exponential, based on money multiplier ran down substantially. Banks are not creating money; it's only the Fed that creates money but it doesn't transform into a lot more Dollars since the demand for Dollars is not as high as before as you already mentioned. Now, on the possible agreement among the central banks, well in Europe, there was an agreement and the euro was created and that's a very good example and that to some extent, saves Europe right now from more problems. They could have much more of these current single national currencies as experienced of Baltic countries, Hungary, and some other countries show right now and they wanted to move to euro unilaterally at some point. Also, we can agree for example, Kazakhstan – these other countries to have the rouble or some mixed currency as a reserve currency between us. And China can agree with South Asian countries and Japan or Latin American countries can agree amongst themselves to have different kinds of reserve currency, partially at least, based on their ideal needs. So, most agreements are possible and more over I think because this agreements will happen. We'll have these agreements around the world. We are moving to this at quite large pace and if the crisis will be a prolonged one, you'll certainly have these agreements. So I think a step by step approach is the right one. We will be moving step by step to the system.

R. Nash:

Dr. Tumpel-Gugerell, the role for regulation in this process from the official...

G. Tumpel-Gugerell:

Thank you. I think the highest priority is getting the regulatory supervisory reform bank in place and to make the financial system more stable because when we achieve, for instance, to better cope with liquidity risk, then its less likely that the country comes under pressure, has no access to

funding and therefore has to devalue. So the better the regulatory reforms succeed, the less likely it will be that we need huge reserves and the less rainy days you have the less often you need the umbrellas. But of course it also makes sense to have stabilisation funds like what we have seen recently, more stepping-in by the IMF in the early age of the process really to contribute to the stabilisation. And this was behind the original idea of the STRs and we should keep this in mind. So I think we have to take several steps at the same time.

R. Nash:

Mr Elliot, maybe I could also ask you to react to the role of regulation in this process.

S. G. Elliot:

How much time do we have? In all seriousness, unfortunately, it seems like in the United States we may be moving backwards with respect to regulation. Obviously the crisis has called into question a lot of the regulatory processes, especially around the oversight of financial institutions and as I'm sure most, if not all of you are quite aware we have a very fragmented regulatory system in the United States and unfortunately, we're even talking about adding to the complexities as opposed to subtracting from the complexity. Obviously, congress will give very much in the middle of all of these and one of the more recent proposals are that we add regulators i.e. put in like an umbrella regulator over the existing structure for systemic risk, carve out another regulator for consumer-type issues so you end up with 7, 8 whatever number regulators as opposed to fewer. From a business perspective, we've really view that we've got to get to fewer regulators. We've got to get to a more "who's in charge", "who's responsible", "who's accountable" because the more and more dissemination and fragmentation we have in the regulatory system, the less and less accountability there is at the end of the day. And so, we're strong supporters for basically one regulator which probably means you have to have at least two at the end of the day to basically get that accountability and get the clarity for the system.

R. Nash:

Thank you. A question I think from over here on the right?

Question from the audience:

We've heard a lot about reforms in the regulatory system and also the creation of reserve currencies. Are these actually fundamental reforms to the global free market capital system or are we actually just talking about, sort of, rearranging the deck chairs on the Titanic here.

R. Nash:

Mr Lipsky, I'm afraid that's a question for you.

J. Lipsky:

Well, the intention is fundamental reforms that's certainly what we've seen over the past months since September, since the unfolding of this crisis there has been an unprecedented degree of international cohesion and cooperation. I think there has been an unprecedented consensus regarding the need for short-term stabilisation policies – the nature of those policies and their implementations simultaneously which has had the – in our view, the important impact and effect in amplifying the impact of these actions. There has been a convergence of basic ideas about what is needed in terms of regulatory reform in the financial system to add stability to the system, to reform the perimeter – to perfect the perimeter of regulation to make sure that no systemically important financial institutions fall outside of the perimeter of regulation, agreement that there's a need for a macro prudential aspect to regulation such that the financial regulation no longer simply focuses on institutions and instruments but also takes in account systemic effects in terms of overall leverage and takes account of the economic cycle. These are concrete program to work out the specifics of what that would mean and to put that into practice and the leaders, some have asked the IMF to help with the FSP in developing and other standard-setting bodies in developing these reforms and task the IMF with monitoring their implementation. This is not simple, it's not easy, it's necessarily going to be quick, but it sounds quite fundamental in its goals. Now with regard to the reserve currencies, what we've heard here is, I think, a pretty good discussion about the kind of aspects that go into the creation of reserve currencies and certainly there was an agreement at the London Summit to substantially increase the supply of allocation of STRs and pointing towards the, among other things, the contemplation of an eventual shift of the role of the STR over time. In the meantime, it seems likely what we've heard here and I think we can all agree that there are fundamental changes afoot in the global economy in terms of the balance and emergence of new economies that is also going to have an impact on what is treated as what becomes a reserve currency, what's going to be important that we retain the international cohesion coherence of policy to be able to guarantee improved stability of the system in the future going forward, while preserving the benefits of open economies.

Question from the audience:

I just have a quick remark. I think we have a very dangerous trend right now in regulation. It is getting more complex and more and dangerous – it is a risky way of de-globalisation of the financial system. It's about financial protection basically, putting financial institutions into national borders. And I saw the proposal of the European commission and that also emphasising to create

regulation standards and basically push banks, financial institutions to have all the business or almost all the business within the international borders to give loans only to national companies to have staff in every – on each particular component in every country you operate. And I think it will be a very good first test for expanded financial stability board and also for post crisis IMF to avoid this kind of nationalisation of the financial system regulations. What it probably needs is more international regulation at the international level consistent and coherent across the world, across the markets, while keeping current national supervision and enforcement of these regulations. Thank you.

G. Tumpel-Gugerell:

There is certainly no effort from the Europe side of the European commission to limit the activity of banks. Maybe you refer to the, let's say, policy of the competition commissioner who has to deal with state aids to banks and to make sure that we keep a competitive playing field and in this context, some banks were asked to sell part of their assets but we have what we have to cope with in Europe that we have cross-border activity of banks to an even higher degree than a few years ago but we still have national supervisors. And therefore, some supervisors are concerned that they do not have access to the information their banks are producing in the country because there might be an international regulator. Therefore, it's very important to get this institutionally reformed, which is currently under discussion by the finance ministers to get these reforms rights so that local supervisors are sufficiently involved in the international activities. But I'm confident that there will be a very good solution to that.

R. Nash:

Thank you. I would just like to ask anybody on the private sector if they would like to make a point about the deck chairs on the Titanic and whether the role of these discussions are in fact useless in the end. No obligation, if you would like to...

S. G. Elliot:

No obligation. I think the, kind of, the cold hard facts of it is, it's going to take a tremendous amount of cooperation, it's going to take a lot of give and take to basically get to the type of cooperation that we're talking about here and have more of a supernatural-type regulator. Again, maybe I'm just taking too much of my experience in the United States and we can't even get our host regulators act together, if you will, I have a hard time seeing how it goes across many countries and many continents.

J. Lipsky:

Maybe just a quick comment. This crisis was brought about by the most tightly regulated sector which are the commercial banks and I think we should not forget this, I mean, I'm working for a fund management firm so we are kind of outside of this tightly regulated sector. You know the idea...

S. Elliot:

That's only temporary.

J. Lipsky:

The idea... and that's precisely the reaction, I think you know, the overkill now, the risk of an overkill that when there will be too much regulation, the public sector has already attempted to regulate very tightly this sector and yet, that sector managed to get away with producing what has become a major crisis. I think it's the quality, I think, of regulation that matters a lot and not the quantity and I hope that will remain the guiding principle when we think about new regulations going forward. I think there is a risk now because it's popular to demand for it to kind of, you know, risk financial repression and I think that would be the wrong direction; we should not embark on it.

R. Nash:

Dr. Reisen I think is the only one...

H. Reisen:

Perhaps, like to come back to one comment here, that gentleman made from the Russian Academy of Science, I think if you want to have a reserve currency, you must accept at the same time that you're running a deficit because otherwise, you would push the world economy in a contractionary spiral, and that exactly led to the creation of the STR. Mr Lipsky mentioned the so-called Triffin dilemma. Actually, Triffin was a Belgian economist who also experienced currency substitution in his country. There was always a venue across Belgium which is a fairly small country, you could find French francs, you could have German deutschmarks, guilder, and everything worked and there was actually no crowding out because they were all more or less stable. A more general remark, I think, as this shifting world scene that we are witnessing now, has very much changed the strategic interests of emerging markets, vis a vis the OECD countries. The emerging markets find themselves to be kept exporters and now have an interest to avoid captive protectionism. I remember the decade, I think it was in the 90s that the OECD wanted to institute a multilateral agreement on investment so that no local national policy was possible to protect against capital investments and I

think now, the Brazils and Russias, and Indias and Chinas of this world would actually be very happy to have this. And while we have seen bouts of capital protectionism in OECD countries, especially vis a vis sovereign wealth funds which I think is very closely linked, by the way, to our discussion because sovereign wealth funds have been getting so strong as a result of shifting out of financial assets into real assets as another form of diversification, and as a form of Dollar risk aversion.

R. Nash:

Thank you. Next question perhaps... I'm sorry...

G. Elliot:

I just want to add one amplification that actually the work over the past year on sovereign wealth funds has been an excellent example of cooperation. On the one hand, in collaboration with the IMF, the sovereign wealth funds created their own organisation and developed their own standards the so-called Santiago Principles, for guiding sovereign wealth and operations and investments and then in the recipient side, the OECD, evolved a set of codes for investment. Like this has been an example of very successful international cooperation to exactly, to keep capital flows open and productive.

From the audience:

You mentioned that some initiative attempts have been made to create regional reserve currencies but you did not express your opinion about it. What's Russia's attitude towards it in general? And there's an additional question: given the complicated relations between Russia and Ukraine don't you think that it's possible to set up a common financial union which would unite historically justified grivny, rouble and a kopeck which were in circulation on this territory three times and perhaps will go about the fourth time? I'd also like to know the opinion of foreign experts on this issue. Thank you.

A. Dvorkovich:

First of all, we have good relationships with Ukraine. The short-term issues that we have will not destroy our strategic relationships, that's clear. Secondly, I'm quite positive about any kind of co-operation with our main partners, to have more co-ordination in monetary policies in managing reserve currencies, whether we'll have one currency unit or not, nobody knows. We are working on these issue with Belarus, for example for a number of years, resulting in success, basically. Exactly since each side wants to preserve its independence in the conduct of monetary into other policies as well, but creation of some kind of monetary union requires giving up some degree of independence

to a supra-national body or to one of the national bodies. You cannot avoid this. So it depends on the political will to do this, on the attitude of people in the countries where relief is a real political and very sensitive issue. Certainly, the current cooperation that we have in bad times with some of the countries including Kazakhstan, for example, creates some ground for a more advanced cooperation in the monetary field in the future. And we heard the proposals from some of our Kazakh colleagues to create one currency or basket of currencies. We are discussing this, that's an interesting proposal. But to forecast whether it will happen or not - it's very difficult, but I'm positive.

R. Nash:

Dr Mandeng, if we could just perhaps widen the scope of the question a little bit, do you think there is the possibility of regional reserve currencies emerging over time, perhaps the Rouble within the CIS, RMB within Asia. Perhaps you can comment on that.

O. Mandeng:

OK. Well, I think certainly the possibility is there and it really depends a lot on Russia itself, of course, whether this would promote the Rouble and will conduct policies consistent with the promotion of the Rouble as a reserve currency. The histories of reserve currencies - there have been countries who did not want their currencies to be used as international currency. Germany for example, discouraged for a long time the German Mark to be used as international currency. If the position is different in Russia, then I can see that the Rouble will become a major regional currency maybe first then later an international reserve currency. Again, I think the key is, will policies be conducive to give the Rouble the statures of reserve currencies, and I think ultimately that will depend on whether Russia itself is willing to subordinate its policies to that objective. It may become, effectively the new - you could argue - nominal anchor for the formulation of economic policy in Russia. That in itself I think is an interesting proposition.

Gertrude Tumpel-Gugerell:

I think setting up a currency union is not easy, but it has a lot of merit, as we have seen in the use of the Euro during the crisis. I think it is useful to look at the trade relations of countries working together and this is a pre-condition I think, and apart from the political will, of course, to go in such a direction, but for us it was a success.

R. Nash:

Thank you. Another question? Perhaps, over here on the left.

Moscow Times:

Hi.

R. Nash:

Could I ask everybody to identify themselves, if they could.

Moscow Times:

Hello, I am <inaudible> from the Moscow Times. Hi. I have two questions, it's actually one question, but it's in two parts. The first part is to Mr Dvorkovich. We've heard the President and the Prime Minister and yourself discuss in all seriousness the rouble as a potential reserve currency. Is there some kind of timetable that has been discussed internally in the government? And if there is, what is it and if there isn't, just your personal opinion - when that could happen - a year or five years, 20 years. The second part of the question is to the panel. When you take the rouble and compare it to the currencies of the other BRIC countries, which one do you think has in all reality, in all seriousness, the best chance of becoming a global reserve currency? Thank you.

R. Nash:

Perhaps, Arkady, you could answer the first question, and then Dr. Reisen and Mr Elliot to try and answer the next section.

A. Dvorkovich:

Sure. Well, as we discussed there cannot be any timetable to create a reserve currency on a national level. It is the same kind of question on what is the timetable to increase the competitiveness of the Russian economy and the Russian financial system - what is the timetable to increase the size and weight of Russia in the global economy. Well, we have a strategy to do this. It's a long-term one but it's all relative. We believe that our policies will lead to a stronger, more stable, more competitive rouble as a result, and to the wider use of the rouble by our partners. And it will happen step by step, year by year, and I don't think there is a point where you can say, "Yes, it is a reserve currency" or, "No, it is still not". We believe that it will slowly emerge as a reserve currency, but I will not give you any indications on the time.

R. Nash:

Dr. Reisen?

H. Reisen:

Yes. Just let us remind people that an international reserve currency normally has three functions. One is that it reflects importance in world trade and output and on that function, it would probably be the RMB which would be the leading contender, not only among all the emerging market currencies but among all world currencies. Another function is the depth of financial markets. China has Hong Kong to a certain extent, but it still does not rival the United States. And I think for the next decade or so, even longer, the United States' financial market provides a debt and liquidity that are important to intervene on foreign exchange markets and so on. So I think this speaks for the Dollar. The third function is the store of value and here I would give my marks to the Euro because I'm confident that the European Central Bank, which is not hampered by a double target as the FED is, but pursues inflation, and has a main job of keeping inflation low, will probably provide the best store value.

R. Nash:

Mr. Elliot.

G. Elliot:

Yes, on your speculation around which of the BRIC currencies has the possibility to be a reserve currency. In my own mind, I keep coming back to the basic criteria of how you become a reserve currency and you have to look at those four individual countries and you say to yourself, "Which one basically has the most diversification?" It would be a big criteria and I think all of four other countries today that you could argue that don't have enough diversification, so they need more diversification at the end of the day. The second aspect would be very much around how does the political system work, is there a good transfer of power if you will, as the political process works, and I think in all those countries, you know, a lot of progress has been made, but you would probably argue that it may not be quite as smooth as it is in some other environments. You also have to look in terms of respect for personal property. I think there you might conclude that more progress needs to be made and the final one that I would put out as a criteria is the legal system itself, making sure that you get a fair, impartial, robust legal system, the rule of law aspect being very much a part of that. And all four countries have, you know, some work to do and I think the one that basically gets it and gets those criteria first has the best probability of becoming the reserve currency.

R. Nash:

As a representative of one of the institutions that trades assets in all of those four countries, I wonder if Dr. Mandeng has anything to comment.

J. Mandeng:

Yeah. Now, this is an interesting question. I mean, if you would look at the BRICs today, obviously, China and India both have quantitative restrictions - almost impossible to assume onshore assets in those countries so that it makes it very difficult at the moment, to trade in these assets actively. The Indian offshore market is very active, we hold a very large position but these are in derivatives and an offshore operation so its not the real thing, really. Brazil, the same it's not fully convertible with the real so we trade extremely actively, but again, it's mostly through offshore transactions. Russia - I mean, first of all, what are the conditions today to really deal in these currencies, and actually, Russia and Brazil probably are the ones where it is the easiest actually to assume exposure followed by India, and China at the moment is almost impossible. So the kind of minimum conditions for any of the BRICs to serve as a currency today - it's quite limited. On the other hand, I think, you know, flip it around a little bit, looking forward, China is already probably today the second largest economy in the world. It's just extremely unlikely we will not be starting to use the RMB in one form or another in the very near future and I think that's the kind of perspective we should have. And just going back on one comment that Mr. Reisin made earlier, the US Dollar is a unique currency and the US financial markets are uniquely deep and as such do not have a rival but I think that should not be the perspective. It is not about replacing the Dollar one for one, it is really finding complimentary arrangements that will over time weaken the reliance on the Dollar. In that sense the Dollar is unrivalled and I think if we go back to Bretton Woods and I think that here history is kind of a good starting point. At Bretton Woods, the US was by far the largest economy and the largest creditor, the largest holder of gold, so rightly so, I think. You know, the arrangement at Bretton Wood was the world economy has to rely on the Dollar. But of course, that has changed. Today China has the largest trade, US is the largest debtor. It's extremely unlikely if we are to arrange, you know if we are sitting together at the table today that it would come to anywhere close an arrangement such as Bretton Woods. The debtor is very unlikely to dominate the outcome of any currency arrangement today and I think that we should keep in mind as well.

R. Nash:

You can say the Russia is the most likely to become the reserve currency.

J. Lipsky:

All I would say is we love all our member countries equally and wouldn't consider picking favourites among their currencies.

R. Nash:

OK, next question please. Perhaps this gentleman here.

Question from the audience: <inaudible>

R. Nash:

Could I ask you to speak into the microphone, please.

L. Panitch:

Sorry. I am Leo Panitch, professor of Political Economy from Toronto in Canada. I think there has been a bit of an air of unreality in the discussion and moments of reality keep coming through, such as the point made by Mr Elliot on the importance of legal systems. Every so often the point has come through again on the depth of financial markets. And that not only applies to New York, but it also applies to New York subsidiary, which is London, and American banks of course are operating or were operating in the city. Since the Euro Dollar market emerged in the late 1950s and early 1960s, there really has been a trans-Atlantic institutional basis for the Dollar's dominance which has continued even through the development of the Euro with Britain not being in the Euro and yet London remaining the place where Euro bonds are issued and handled. And this reflects a deep institutional depth which was indicated by Mr Elliot's first point that when the crisis hit, it hit the deposits of his bank - increased enormously. As Dr. Reisen said at the beginning, world currencies have gone along with world empires and it's not easy to displace them. The kind of empire the United States is, which is an informal one, nevertheless, will not be easily displaced because since the 1930's, international capital has had most confidence in the American state as least likely to abrogate property, which was I think that the point that Mr. Elliot was making - and that remains the case today. What is more likely - instead of encouraging the countries of the south to engage in an illusion that their currencies are likely to become world currencies, we are much more likely to see a return to capital controls as an attempt to protect themselves. Now, I realise a meeting like this is designed to obviate that, but it's much more likely rather than looking to become reserve currencies in a utopian fashion, within anything like our life span that we are going to see a return to capital controls, both internal and external.

R. Nash:

Arkady, maybe I can ask you to comment on utopia, or in particularly the legal institutions that needs to be set up and specifically whether there's any plan at all to implement capital controls as a result of the crisis.

A. Dvorkovich:

I hope countries will not reverse their policies to reinvent of capital controls that in the current financial world given the technologies that we have far proved to be completely inefficient tool to conduct policies and plays a counterproductive role. But this is exactly what I was thinking about when I mentioned financial protectionism, there's a kind of capital control that is appearing already across the world, still not from the legal perspective and it's not the Euro capital control, but the fact there are signals from various Central banks to national financial institutions to keep money in the country and not go into other currencies and other assets and as I already mentioned its dangerous. Certainly in Russia we are not going to go to capital controls, we had a most negative experience with that in terms of the efficiency costs. I think that any kind of arrangement to have a stable international currencies system would require international agreements that can be concluded either within the scope of IMF for instance or just an agreement among countries, legally binding agreements that will put some responsibility on those countries that have higher weight in the global economy and issues reserve currencies. We will need to agree on some obligations of these countries, where those countries will have to take warranted obligation on themselves to comply with certain rules of the game. Thank you.

R. Nash:

Dr Reisen, perhaps you could say something on whether it's utopic to believe the emergence of other reserve currencies is likely.

H. Reisen:

Well, I had speculated that it was in 2050, but that will be after my lifetime so I cannot be monitored on this. I'm not sure. I was thinking of Friedrich August von Hayek, a Nobel prize winner in economics who declared that capital controls were the road to serfdom. And I think if I understand Mr. Dvorkovich correctly, he at least did not say that, but they had bad experiences and one has to see where these countries come from. It's not only Russia, it's also China, and to a certain extent its Brazil and India, they all come from planned economies. You had narrow socialism, you had communism here and the former Soviet Union. You had Mao in China and the results were really anything but happy. And therefore, I think there is also a strong tendency to avoid the capital protectionism on behalf of the BRIC countries and therefore I think the search for solutions along an extended SDR seem to me not unrealistic.

R. Nash:

OK, thank you. I think we have time for one more question. Gentleman in the front.

From the audience:

Dear experts. I'm Lyzlov Dmitry Vladimirovich, Russia. I have a question. Counteracting the crisis is important for each of the countries but has the "leak" in the boat of capitalism through which the money leaked away been found? In other words, do we know where have the capitals, the funds that were in the system gone? Has the hole been found? Can you show it?

In my opinion, according to the data that are currently circulating in the mass media the majority of funds on the eve of the crisis were taken out by the largest financial groups and transferred into the government bonds of the US. Thus the trend that had been set for the dollar over the recent time was interrupted. I mean, in the last few years the dollar was fatally falling down on many world markets, and its value was decreasing. Due to a common mechanism envisaged by the general law of interdependence between demand and supply the deficit of the dollar system was created. However, when the dollar was falling down, the funds were taken out of the finance system and allocated in government securities of the USA. Consequently, the entire system encountered severe deficit. As we know, in the conditions of deficit commodity will inevitably become more expensive. It has lead to the situation when almost in all countries the dollar restored its positions thus assuring the growth of its purchasing capacity for some time.

So, I'd like to know if the crisis is the result of actions of certain individuals or a different source of disappearance of funds has been identified.

R. Nash:

Mr. Lipsky, if I can ask you...

A. Dvorkovich:

May I just start in Russian. The Prosecutor's Office of the Russian Federation is working on this issue. Seriously speaking from a practical perspective if the money goes to then yes, the government used this money to finance also financial systems, and all other things so the money didn't go somewhere, still in the market. Thank you.

R. Nash:

Mr. Lipsky, very briefly: where's all the money gone?

J. Lipsky:

Into SDRs. Of course part of the answer is that there's been a significant loss of values, significant loss of net wealth in this process, so some of the money is gone in that sense. Of course as if you heard the early part of, the most turbulent part of crisis in September and after there were some really violent flows into Dollar and then back out. If we're looking forward and we've seen that the

legacy certainly has been first a flight to safety, a flight to perceived quality that is only slowly getting reversed, and is only partially reversed. Of course if we're going to restore global growth one of the tasks remaining before us is to restore the full functionality of the financial system and even in the advanced economies. There's been a lot of work done by the monetary authorities, by the IMF that has had beneficial effects, but we're far from healing the financial system completely. There's still a lot of work to do.

Niclas Sundstrom:

Just with a quick practical follow-up in the interaction between the policy makers and market in terms of the multiple resell currencies. Russia and China has taken the leadership now in these issues, themselves following the changed global environment. but there are also movements on the practical side. So there would be an interaction between what the market does and what the policy makers do. And we've heard earlier about New York and London being obviously the world twin financial centres. But we should remember that this is not necessary forever - there will be other centres coming. And I can tell you that I'm seeing personally, practically very advanced preparations from large by-side institutions looking at other locations moving out of London, moving out of New York and looking for new emerging financial centres and in this context I think Moscow, Shanghai - these are very interesting projects that are not utopian and that we are likely to see within our life time. Thank you.

R. Nash:

Do you want to comment on the move to different characters?

O. J. Mandeng:

I can only agree, I think we should adopt the financial system to what has become an economic reality which is emerging markets we believe will be out on top following that crisis. The crisis has moved forward what will be the dominance of the emergent markets in the international economy, ultimately that will be reflected in a shift of the financial centres from what are today's core economies of the future and certainly the two cities you've mentioned are two, and I can see many others as well that will emerge in that regard.

R. Nash:

Well thank you. That just leaves me to thank all of the panel for this session. I think its been fascinating, we're living in extremely interesting times to be discussing this question in this city in the forum with this panel. Thank you very much indeed.