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The Global Growth Agenda

EUROPEAN FISSURES: TAKING THE HARD DECISIONS TO END THE CRISIS

SPIEF Open Debate

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__**Moderator:**__

Nik Gowing, International Broadcaster, Journalist

__**Panellists:**__

Sir Suma Chakrabarti, President, European Bank for Reconstruction and Development

Jim Cowles, Chief Executive Officer for Europe, Middle East and Africa, Citi

Luciano Jannelli, Chief Economist, MIG Bank

Emma Marcegaglia, Incoming President, BUSINESSEUROPE

Peter Siyarto, Secretary of State Office of the Prime Minister of Hungary

Alexei Yakovitsky, Chief Executive Officer, VTB Capital

N. Gowing:

Good afternoon. Thank you all for your attendance. I do not know how many people are going to turn up, but obviously there is still anxiety about Europe. I ought to clarify one thing: we are going to be talking about European Fissures – Taking the Hard Decision to End the Crisis. Participants from the Russian Federation will have wondered about the translation because the translation which went out was about choice, or selection. The real meaning of this discussion is about where the divisions are, the schisms, the cracks, the *treshchina (*fissure). So that is critical for us to understand: where are the divisions now in Europe. That is what we are going to discuss.

I feel like this session is a bit like the waiting room for the President. Several people are going to have to leave before the end of the discussion in order to go and wait to see President Putin; others may come in, including the Dutch Prime Minister, who is currently there. Whether we will get to hear from anyone who has been to see the President, and whether they will be here in time before the end of the session, I am a little unclear, because that is the way things happen.

In any case, what I would like to do is indicate to you how I would like to chair this session. One of the reasons why I have placed a laptop computer over there is for you to use one of those two addresses to e-mail or Tweet a question or a point to me, while you are listening. That means that I can pick up those points very quickly, as they are on your mind, as anyone speaks.

What I will do, particularly because time is short, is that I shall go through the introductions as each of the panellists speaks. I would like you to feel that you can enter this conversation much sooner than normally happens, even though we have currently got six or seven panellists. We hope to see the Dutch Prime Minister shortly. Ms. Emma Marcegaglia will have to leave at about 16:15 to go and take her place in the waiting room; also, Sir Suma Chakrabarti from the European Bank. So, that is where we are at. Anything could happen in the next hour and a quarter.

Let me, first of all, turn to Mr. Peter Siyarto who is the Hungarian State Secretary for Foreign Affairs and External Economic Relations. I would like to hear from you, about what the atmosphere is currently like inside the councils that you attend and about whether there is a feeling of stability returning or not. And, please, if you have a Tablet PC or a Smart phone, do not hold back.

P. Siyarto:

Good afternoon to everyone. Chair, thank you very much. The most important question inside Europe and the European Union right now is to identify the most important problem and challenge which, according to our understanding, is the indebtedness of the member states of the European Union.

Just to give you some facts, the total state debt of the European Union now is EUR 11 trillion. This means that the yearly debt service of the 27 member states now reaches EUR 2 trillion, which is a huge burden on the national budgets. We, as EU 27, generate EUR 1.2 billion of debt every day, which is incredible.

This gives you an insight into why the European Union is losing competitiveness. We produce 20% of the gross GDP, but in the meantime, we distribute 50% of the gross total on welfare spending, which means that this kind of approach makes the European Union less and less competitive over the years.

We understand that, in the European Union, we have to tackle the debt challenge. The main dividing line between countries is regarding whether or not they can tackle that challenge. What Hungary has done is that we have created a new model of the economy, called the ‘workfare society’. The ‘workfare’ society replaces the welfare society.

We have created a workfare society, which is based on lowering state debt, lowering the budget deficit and, in the meantime, finding a balance in these measures to make economic growth possible.

According to our understanding in the Council, the main dividing line, as well as the main challenge, now is the indebtedness of the European countries.

N. Gowing:

State Secretary, thank you. Just before I hand on, and we hope to hear this from the Dutch Prime Minister as well, but how would you describe the political atmosphere in the councils you go to, alongside the Prime Minister?

P. Siyarto:

Everybody is hoping for a better future.

N. Gowing:

Is hope a policy?

P. Siyarto:

Now, at least, we agree on what the main challenge is. Sometimes we only agree that we disagree, but in the meantime that there is more and more hope in our capacity to find a solution which is closer and closer.

N. Gowing:

Would you say that there is a level of confidence now, after four years of this?

P. Siyarto:

Confidence is growing about finding the solution.

N. Gowing:

Thank you. Jim Cowles, please go ahead.

J.C. Cowles:

I would like to make a comment.

N. Gowing:

I should explain that you are the Chief Executive Officer for Citi in Europe, the Middle East and Africa. A quick comment on that first of all, if you can, Mr. Cowles, on what the State Secretary has said.

J.C. Cowles:

I agree that indebtedness is a critical issue as we take a look across the eurozone and the EU. I also agree that we have to look at various countries and see whether or not their debt levels are actually at unsustainable levels.

However, I also think that when we take that look, particularly across the eurozone, we also have to take a look at regulatory reform. Some countries have made some progress in terms of regulatory reform, employment laws, pension payouts and pension plans. They have also come through with some very good regulations in terms of encouraging youth employment, which is critical. However, to the extent that we focus only on austerity measures, we miss the other half of the equation, which is to make sure that we have the necessary regulatory reforms that will make those countries more competitive economically. Together with some cases of austerity, we should also look at some economic stimulus perhaps, in terms of how we build infrastructure and how we invest in that infrastructure.

One of the biggest issues, in my opinion, that we face across Europe, and across many countries in the world, is youth unemployment. Unless we address that, then we are looking at a generation that perhaps could be lost, from an economic point of view.

N. Gowing:

Let us pick up on those two points in a little more detail later. Let me go to Sir Chakrabarti now, the President of the European Bank for Reconstruction and Development (EBRD). Regarding European fissures, do you think hard decisions are still needed at the moment, Sir Chakrabarti?

Sir S. Chakrabarti:

The existentialist crisis in the eurozone is over. I do not think the eurozone is going to fall apart now. However, I do think there are three issues which are really about fissures and divisions of opinion. They all link to Mr. Cowles's point about growth and jobs, and particularly youth unemployment.

Firstly, there is a very interesting situation now, where a division exists between countries on whether it is actually a good idea to go to the IMF or not go to the IMF, in terms of presenting yourself for the future. Slovenia, for example, which some would argue should go to the IMF, does not want to go to the IMF, for fear of what that will do to its reputation. Romania, which may not need to go to the

IMF, does want to go to the IMF, because it thinks that will advance its reputation with investors. So this is actually quite an interesting new story, post-Cyprus.

Secondly, I agree with what Mr. Cowles said about how well many of these countries, including Hungary, have tackled their budget deficits. They have done a very good job and quite often it has been very difficult politically, but they have achieved those things, all these countries.

I do worry, though, that in doing so, the composition of expenditure, the things that they have cut spending on, are actually the things that are growth-enhancing. Infrastructure was cut because capital expenditure is easy to cut. Civil servants are more difficult to cut because they are very visible, and they vote. There is a whole set of issues about the composition of expenditure and, given the progress all of these countries in Eastern Europe that I deal with have made in their debt-to-GDP ratios, whether there is at least room for some stimulus around infrastructure, or SMEs; something that is more growth-enhancing in their budgets.

Thirdly, and this again links to the regulatory point that Mr. Cowles made, we need to look at structural reform. It has been somewhat neglected over the past few years because it may have politically been very difficult to action budget cuts and take on vested interests at the same time. However, this has to be done if you action structural reform, because someone is going to lose out under the existing policy approach. If you look at the whole privatization saga, it has been dead in Eastern Europe for some years now. Quite honestly, it has to be tackled, both from a budget point of view and also in order to attract growth and to attract investors.

These are the three fissures there that Europe needs to tackle.

N. Gowing:

What is your opinion on the confidence levels?

Sir S. Chakrabarti:

Business confidence levels in many countries are low. It is not just FDI, although FDI has been a problem. Hungary, which used to be the star performer in FDI, has a very good stock of FDI of course, but it is the flow that I am worried about. That is a concern throughout our region, and also includes Russia.

As well as the fact that domestic business people are saying that they currently do not have the confidence to invest. You can see that in EBRD's own portfolio. We had a bumper year last year, but why is it slowing down in certain countries? Because, actually, many business people are lacking confidence in going for deals, and certainly large deals. They are tending to go for very penny-packet sort of deals.

N. Gowing:

Thank you, Sir Chakrabarti. To all participants, let me remind those of you who have just arrived that there is another way of entering this discussion. You can e-mail your thoughts on an issue using your Tablet PC or your Smart phone to one of those addresses, then I can see them and I can help put the conversation in the direction of these thoughts.

Let us go to the incoming President of BusinessEurope, Ms. Marcegaglia. You are an Italian entrepreneur. You come from a very large steel and tube-making business and on July 1, you will be appointed President of BusinessEurope, which represents 21 million business people and 41 large organizations in Europe. What is your assessment of whether there are still significant fissures out there?

E. Marcegaglia:

Thank you, Chair. Europe still has a lot of problems that it needs to solve. The situation could get better in the second half of 2013, hopefully at the beginning of 2014, but there are still a lot of problems.

In my opinion, we ought to concentrate on the following: we have to take action to improve competitiveness; we have to rebuild business confidence, which, in my opinion, is still low, and we have to restore private investment.

How can we do this? Firstly, we have to stay open in trade. We discussed this a lot this morning; it is a very important point for enhancing growth. There is no public spending on it, but it is a very important tool for enhancing growth. So we have to keep an open market with Russia, and with the United States, with all the economically important countries.

Secondly, there is still room to work on structural reforms. Some progress has been made in some countries in Europe, but there is still room to make reforms. For example, in labour market flexibility. There are still countries in which the labour market is not flexible enough. There is a problem of product market competition; there is still the problem of the regulatory burden on business. So we have to continue on this point.

Thirdly, we have to stay with fiscal consolidation. In the long term, to have solid growth, we need fiscal consolidation; we have to lower the debt and lower the deficit. However, I do not think this is enough, we have to also action other things. We have to solve the problem of access to finance for investment at reasonable terms. There are some countries, mainly the southern countries in Europe, where there is a big credit crunch, which is a significant hindrance to growth.

Secondly, and it has already been said, we have to work on infrastructure. We need some support for infrastructure, on regulatory burdens, but also some funds to invest in finance.

Thirdly, we have to go on and complete the single market in key areas. I am thinking about services, energy and transport.

Finally, we have had a very good discussion with my friend from the Dutch Association in Dublin as part of BusinessEurope. We decided that we would like to have a different energy policy in Europe. We would like to not only engage on climate change, which is important, but we also have to deal with competitive energy costs. If we also consider, for example, what is going on in the United States with shale gas, we also have to be more competitive on energy costs and not only think about climate change, which is important but not enough.

N. Gowing:

May I bring up two or three points which have already been made?

The first point is what Sir Chakrabarti talked about, the danger that too much spending has been cut in growth-enhancing expenditure. Secondly, what Mr.

Cowles was talking about, regulatory problems. Thirdly, the challenge of youth unemployment. From your business perspective, what is your view of the way this has to go in future?

E. Marcegaglia:

Regarding public spending, what has been said is true. When there is 50% of GDP allocated to spending on public welfare, that is not good for the economy. We have a look at cutting public welfare spending. Of course, we have to choose; you do not have to cut everything.

N. Gowing:

Sir Chakrabarti's point is that growth-enhancing spending is being cut.

E. Marcegaglia:

It has been cut, I agree with Sir Chakrabarti on that. We have to stop cutting that, but there is still room to cut unproductive public spending.

Regarding youth unemployment, discussions are being held in the European Commission right now on the so-called Youth Guarantee. That is a very positive step. The European Youth Guarantee essentially states that an employer can hire a young person, but if there is no growth they cannot stay in the long term. However, I think, the real solution for youth unemployment is a return to growth.

And the third was regulatory problems, you said? There is a lot to do still, at the European and the national level.

N. Gowing:

We have a point here from Ms. Ekaterina Ushakova. It is about the interaction between the organs of executive power with businesses in the information sphere. It asks about this problem of relationship here, between executive power and business in the information sphere. In other words, between the organs of executive power and business. The relationship there: are you worried about that?

E. Marcegaglia:

I am a little bit worried about that. We have to improve matters on this point. There are some problems there.

N. Gowing:

Thank you. We shall see you work on this from July 1.

E. Marcegaglia:

Thank you very much.

N. Gowing:

Ms. Emma Marcegaglia is leaving us now to go to President Vladimir Putin's office. She is replaced here by Mr. Adrian van den Hoven.

Allow me move the discussion now to Mr. Alexei Yakovitsky, who is Global Chief Executive Officer at VTB Capital. Your assessment, Mr. Yakovitsky, of where the fissures are at the moment in Europe? Or are they being mended, in your view?

A. Yakovitsky:

Thank you. It is a pleasure to be here. I shall like to offer an outsider's view, obviously, on what is happening in the eurozone.

I shall like to make three points. Firstly, I absolutely agree with you on the debt issue. Ultimately, however, the resolution of the European crisis is about economic growth. One aspect which is worrying so far is that the economic adjustment in the eurozone has been reasonably one-sided. It has been happening largely at the expense of what is sometimes called 'the periphery', southern Europe, the debtor or deficit nations, via internal devaluation, via cuts in real wages, and a deterioration in income levels and living standards. From the standpoint of growing competitiveness and improving current account deficits, this is all well and good. However, it is not helping to grow the economy. Nominal GDPs are actually shrinking. Obviously, the intent is different, but that is something that is clearly not working.

On the other hand, if you look at, for example, Germany, or northern Europe more broadly, these are the surplus economies with significant productivity potential. They have so far kept fairly conservative policies; they have been sticking to their balanced budget rules. They have not actually been helping—if that is the word—to rescue the very large markets where a lot of their consumers reside, especially the consumers of Germany, as a very export-oriented economy.

My first point is that there needs to be a decision on whether the North actually needs to do that. And if the answer is yes, the South is not going to make it without the North truly being involved. That is point number one.

This takes me to my second point, which is the European monetary union in the long run. Even in the medium term, without fiscal and banking union, or at least a clear movement towards them, is not going to survive. At some point, the periphery markets, or maybe even the core markets of the northern, more balanced parts of Europe, will decide that they want to pursue their adjustments on their own and ultimately exit the union.

My third point is as a banker. I have to talk about banks because, obviously, banks are important. They are important but they are not in good shape in Europe. They are in peril. They are stretched. They are undercapitalized. If there is a menu of tough choices to be made in Europe, the one that needs to be made fairly early in the process, more or less now, is the one on banking sector restructuring and recapitalization. Because the alternative here would be zombie banks; a bit of a Japanese scenario, which, to be honest, would mean years and years of no growth. Without banking sector restructuring we will not have transmission mechanisms, there will be no provision of credit, which is the basic function of the banking system. Unlike Japan, however, which is a nation state that will survive and is surviving, although with a bit of a temporary problem, the European Union may not actually last if the whole purpose of the union is not being delivered. Neither zombie banks nor a large delay in the reform of the banking system therefore are options, in my opinion, that Europe should be entertaining. Thank you, those are my three points.

N. Gowing:

Thank you, Mr. Yakovitsky. Could I also please ask all of you to pick up on this issue of banking union at some point when we come back to all of you? Mr. Cowles, could you pick up on that and perhaps build on your other remarks of a few minutes ago?

J.C. Cowles:

Certainly. First of all, obviously coming from the banking industry, I will go ahead and focus my comments on banking reform and financial institution reform. I do think it is imperative that, when we look at the reform, we have harmonization of the regulations across the different jurisdictions. We see reform proposals coming out of the EU, out of the United Kingdom, out of the United States, and it is important that we have a degree of harmonization as we look at this.

I would like to make two basic points. Again, picking up on the previous points, the first one would be that it is imperative that we push through on Basel III. A number of banks, including Citi, are embracing Basel III. Even though there is still the question of when it may be adopted by certain countries, and there is still the question of some of the financial ratios, many institutions, including Citi, have adopted it. We are pushing through it and we think that is very important. It is what our investors, our clients and our regulators want to see. Our investors are going to react positively once we get to Basel III and we believe that our costs of capital will come down as a result. We believe our clients want to see us compliant with Basel III because they will have more confidence in our financial institution and our financial strength as a result of it. And, obviously, the regulators want to see safe and sound banks as well.

The other thing I would like to say about Basel III is that it increases capital ratios. It also introduces risk-weighted assets (RWA) as a definition in terms of looking at your balance sheet and looking at the amount of risk you carry.

Picking up on the last point, a number of US banks, particularly the global ones, have been scaling back their balance sheet over the last five years. This has meant that we have healthier, more robust banks. A number of banks in the EU have been slow, in terms of picking up on deleveraging their balance sheets.

Until you see that deleveraging, you are not going to have healthy banks that are in a position to spur economic growth. Deleveraging also has the very positive impact of focusing banks on their traditional strengths. If you are not going to have 30:1, 40:1, or 50:1 leverage, and you are going to be restricted by the size of your bank, then you are going to go ahead and take those finite resources and conduct them into businesses where you have a competitive advantage, which again brings more discipline to the way you run your bank.

In terms of banking union, it is, again, imperative that we move forward with a banking union across the EU. Having a single bank supervisor, again, brings a consistency across the EU in the rules that are going to be applied. Having a single resolution mechanism, or at least a common understanding of how financial institutions are going to be resolved, is very important in raising investor confidence.

Having a uniform deposit insurance plan is also critical. If we look at the issues that happened in Cyprus, we can see that when they were going through their issues earlier this year, the necessity of having a uniform deposit insurance plan is critical.

Once a banking union is established, once we have the ability to know how we are going to resolve institutions, then we can come through for the EU with stress tests similar to the CCAR plan in the United States, which again is a step in the right direction.

We need to obviously have safe banks. We have to have global consistency in common rules and regulations, so that investors and regulators and banks themselves know what the rules are. However, banks are always going to have to take risks, of course. If banks do not take risks, then, obviously, we are not going to get the economy moving forward.

N. Gowing:

Thank you, Mr. Cowles. Mr. Yakovitsky asks, via Twitter, whether the EU should have a stabilization fund that is contributed to by all member countries? As you have the floor at the moment, Mr. Cowles, we will hear from you first.

J.C. Cowles:

I would say that the answer is yes, sure. It should have a stabilization fund, again, so that there is confidence that the funding would be there. However, the other thing is that when we take a look at resolution of banks, the key thing is to go ahead and push forward with bail-in, as opposed to bail-out. To push through the whole idea that if you are a debt holder in a bank, or you are an equity holder in a bank, then, obviously, if that bank encounters financial problems, you, as an investor, stand to lose. That is where a bail-in will go ahead and protect the institution so that it can continue to go forward. Because of the bail-in you would therefore, hopefully, not need to use that stabilization fund.

N. Gowing:

I would like to hear from the others as well, later. Dr. Luciano Jannelli, let me come to you for your reflections on where the fissures are in Europe at the moment, or whether they are healing or coming together.

I was particularly interested in one of your notes beforehand, where you said it is difficult to assess the impact of the euro crisis on Europe's standing in international relations, and that it might actually have strengthened rather than weakened that standing.

Dr. L. Jannelli:

Thank you, Chair. That note was simply a consideration that the crisis has forced European governments to take decisions on important financial and monetary matters. And, of course, the key to understanding Europe and comparing it to other economic powers is that it tends to be more divided because it is a collection of states that still have a certain degree of sovereignty. The fact that the crisis has pushed them to make decisions, over time, might increase their standing in international power relations. I understood that that was one of the questions of this panel. I add that I said 'might' because this kind of thing—how a nation's standing grows over time in international relations—is something that one cannot judge immediately. It takes time. Then again, if you think of central bank liquidity injection as a currency war, and I personally do not think of it like that, then it is fair to say that Europe has been the less bellicose of the G5. So maybe that again would indicate that Europe's standing is actually a 'staying on the sidelines'. It is still very difficult to judge this right now.

I would like to come back to the considerations on banking union and to talk about the issue of fissure there. I hear my co-panellists saying that it is very important to have a bail-in regime. I am afraid that if you precipitate a bail-in regime, and you do not have a clear understanding on burden sharing, then you make things worse for the countries that are suffering the lack of a single banking market, of a single credit market. You also have to be very careful with the stress tests and what you are going to include in them. Then you get into the nasty loop of the fact that a lot of Italian and Spanish banks have Italian and Spanish government bonds.

So these things have to be clarified. I am a little bit concerned, to be honest, by the fact that there is much more discussion about bailing-in than about a commonly funded resolution fund. There is a tendency for the core countries to have a resolution authority which resembles a collection of local authorities more than a truly centralized authority. This is a key problem.

What I would like to say, and here I conclude, is that one should not look at it as a problem for the periphery countries alone. I would say that the crisis of the last five years has clearly shown that there is no relation between a fiscally sound country and the quality of the management of the banks in that country. By not tackling this issue, and by not creating a true single credit market, a big economic inefficiency will remain in the eurozone. That is very serious and the European Central Bank (ECB) is very concerned by that. People talk more about the fact that the transmission mechanism of the ECB does not work. That is the ECB's concern. My concern is that you do not have a single credit market, and that there is a huge economic inefficiency.

N. Gowing:

Thank you, Dr. Jannelli. There are a lot of issues that we have already raised. We have raised the issue of austerity, bail-outs or bail-ins, and also what Sir

Chakrabarti said regarding his concern about too many growth-enhancing spending programmes actually being curtailed at the moment.

State Secretary, as someone who has to think of the politics of this, do you believe that now, within Europe, in the councils that you and your colleagues attend, there is now a greater willingness to understand that there are ways of mitigating problems? Because if what Sir Chakrabarti says is correct—that actually more problems are being created for the future because growth-enhancing spending is being cut back—then that is leading to bigger problems somewhere down the track.

P. Siyarto:

Thank you very much. The thing is that our opinion has been, since we have been in power and since this crisis began, that you have to find a healthy balance between austerity packages and growth-enhancing measures. You should not go either this way or that way. Unfortunately, our former governments in Hungary committed this mistake. They only went with austerity measures in order to find a fiscal discipline. They did nothing in order to boost economic growth, and that created a whole new set of problems. So we are coming to a compromise now, more or less. We have to find a healthy balance between fiscal consolidation and fiscal discipline, between lowering budget deficit, lowering state debt and boosting economic growth.

I have to tell you that in Hungary, especially, austerity packages have failed. They created a whole bunch of problems for Hungary. That is why we were in a very bad position, between 2008–2010, when our state debt reached 85% and our budget deficit was up there at 7%. It was because of the failure of austerity measures. Since 2010, we have restructured our whole economy in order to be able to grow and, in the meantime, to remain very disciplined on fiscal issues. Now we have a budget deficit of 1.9%, and we have decreased our state debt from 85% to 77%.

N. Gowing:

Thank you. I would like to remind everyone that if you would like to contribute a thought to the discussion and you have a Tablet PC or a Smart phone with you, please send me a line or two, because I can then contribute your thoughts. Here is one: would a change in monetary policy help countries which seem to expect bail-outs? Sir Chakrabarti, can I come to you and ask you to comment on this proposal, or thought? When you are thinking about fiscal discipline now getting entrenched in many European countries, but with still a lot of liquidity around, you say the emphasis should now shift to structural reforms. Push that further, and give us an idea, particularly hearing the Hungarian experience.

Sir S. Chakrabarti:

Essentially what I am saying is that there are some simple things that many countries need to do around their investment. There are some things that countries need to do which have been politically difficult to achieve, I admit that, around their investment climate. Too many countries in Europe do not recognize that they are in a global competition, frankly, for foreign direct investment, and it is not going to come to Eastern Europe very easily. When I go marketing now in Israel, India, the States, it is a very hard sell compared with other destinations. Sub-Saharan Africa is far more popular at the moment than anywhere in our region.

I want to change that, but the only way to do that is, quite honestly, to change some things which we all know need changing: corruption issues abound; the way court systems work; the ad hoc behaviour of tax and customs authorities; all those sorts of things that we know require political action. That is one set of issues that we should address.

The second set of issues, which a couple of people have touched on, it seems to me, is that credit growth has dried up. The problem now is not one of liquidity; the problem is getting the money out of these banks into the real economy. I have just arrived back from Romania where non-performing loans in the banking sector are at 19%. In Albania they are at 23%, and similarly in Montenegro. Put simply, banks have become so conservative, based on those NPL rates, that the money is just not flowing out. So one of the things the EBRD certainly does, and others help us to do it, is to tackle those NPL rates. But how shall we do it? Do we create a bad bank–good bank sort of approach like we did in Latvia, for example, in the past, to help those countries get out of that situation, so that the local banks can start lending again? At the moment, their objectives are actually not necessarily to lend at all. That is not the sort of objective they are setting themselves.

N. Gowing:

Let us hear from the bankers. Mr. Yakovitsky, what is your view about this quandary, that there is plenty of liquidity, yet it is all too expensive, and not enough of it in the market?

A. Yakovitsky:

Thank you. As I said, and you picked on up this point very well, regulation is good. Basel III is a fantastic system. The previous 15 years have shown that regulation needs to be changed and improved; banking needs to become more transparent and needs to be different. Basel III is conceptually the right thing and the right direction to be moving in.

I would argue with you that timing of the regulations is important and that the execution of Basel III is important. It so happened, very unfortunately, that the two things coincided poorly. The execution of Basel III and the tightening of the regulations coincided with the worst possible moment in the European economy.

N. Gowing:

Can you feel that it will loosen up, though, Mr. Yakovitsky?

A. Yakovitsky:

My answer is no. Hence, to mention what has already been mentioned a few times: structural reforms. It is not only about the provision of credit, even though that is a big issue. If Europe does not recapitalize and does not restructure its banking system fairly quickly, it will have to rely on the Americans, or maybe the

Chinese, at some point even on the Russians, a lot more than it would ever want, in my opinion.

Alternatively, a major step forward in the investment climate, in structural reforms, in an overall decrease in the public sector, in privatization, in all of these things is that if you cannot step back on the regulation, you have to find a way around to stimulate growth and to provide credit to the economy.

But, as I said, unfortunately this coincidence, from my perspective, is a fissure that is there. You can heal it a bit, but you are not going to get rid of it, unfortunately, in terms of timing.

N. Gowing:

The view from BusinessEurope?

A. van den Hoven:

I would like to raise a couple of points where I disagree with some of the things that have been said around the table.

First of all, yes, industry is facing a credit crunch in some European countries. This is leading to disinvestment in the industrial sector and creating a major problem. So the banking union does need to go forward. I would agree, of course, that we need a resolution mechanism otherwise a banking union is not worth the paper that it is written on.

A second point is that we have to be careful, because today European member states are spending more on debt servicing than they are on education. If we keep spiralling the debt out of control, we will not have any investment with which to do anything, including investing in the future of young people, which is probably the most important thing. But you can also see it in European regulation.

Here, when we talk about Basel III, we are also in favour of Basel III. However, the way the European Union is implementing it is to the detriment of industrial lending and in support of lending to states. I will explain very briefly why that is the case. Capital requirements basically require that the capital held by banks remains liquid. And the law says that the most liquid assets are government bonds. So, for instance, Belgium, which is the second most indebted member of the OECD, after Japan, has a better rating for a bank than a major industry that is, for instance, completing a capital project here in Russia that is almost guaranteed to be paid, if we were to take an energy investment example here. We will see over the next few years that it is not just countries on the periphery, but European industry as a whole, that will not be able to obtain export credit insurance for major capital projects. Which means that we will not be able to compete, for example, in the Russian market, for big oil projects for example, with European financing because the capital requirements disfavour industrial investments.

So when we look at things like Basel III, we need to ask ourselves: do we really want to favour banks holding more and more government debt, as opposed to perhaps, in some cases, less risky industrial project debt? That is the question we need to ask.

N. Gowing:

Let us ask the bankers again. Mr. Yakovitsky, or Mr. Cowles, or Dr. Jannelli, what is your view?

J.C. Cowles:

I would like to say a couple of things. First of all, the concept of having risk-weighted assets is important. That it is important that, when you take a look at a balance sheet, you do not treat every single asset the same. So that is the principal. The application of it though, I would agree with you, needs to be modified in some situations. It is not correct to say that every sovereign debt out there is a better quality than some corporate loans. So the concept of RWA is important and we can talk about the application of it and how it is actually looked at.

The other thing, and we have talked about this to some degree, is what has happened with that mechanism, in terms of looking at monetary policy. Are we getting the interest rates as they come down? Are we getting it to flow through to the actual borrower? It is a little bit of a bifurcated situation, dependent on what

part of the market we are looking at. I know from our perspective, we have increased our corporate loan book in EMEA, and more specifically in Europe, by about 22% over the last two years. Now, the part of the market that we bank on are larger corporations. I think one of the issues here is, how do you get more funding to the SMEs? How do you go ahead and get that part of the transition mechanism going?
Recently, we completed a transaction in Greece with the European Investment Bank (EIB) where they came in and provided some guarantee funding for a USD 500 million SME programme that we are participating in. That is the type of thing that is very important in terms of how do you actually get the funding to these SMEs which are so responsible for economic growth and for an increase in employment going forward.

N. Gowing:
Sir Chakrabarti?

Sir S. Chakrabarti:
I agree with Mr. Cowles about the SME point. However, the issue is picking the right SMEs. If you look at the history of the last 40 to 50 years, a lot of SMEs have failed because we did not do a very good analysis. Over the past decade, what has happened in Europe is that those banks that knew their SMEs, have actually lost touch with their SMEs. So, if we are going to design these sorts of programmes, which I am in favour of, we have got to put a lot more effort into the credit officers of the banks knowing their SMEs, putting a lot more effort into the SMEs, so they can actually work up proper business plans. We see a lot of these business plans actually not being very good, not being thought through, because people have lost the skills to do that, on both sides of the fence. So, yes to SMEs, but with due care.

N. Gowing:
Mr. Jannelli, do you want to come in, representing your bank?

Dr. L. Jannelli:

I just wanted to think about the fact that there is so much government debt in European banks. There has been a very simple historical development a couple of years ago. The point is that the ECB could not buy government bonds, so instead of having the ECB do it, Mr. Draghi devised the LTRO, so it was the banking system that bought the government bonds. This is due to the fact that the monetary policy in Europe cannot be the same as in any other country. That is a key issue and explains why we have also had an increase in the Balkanization and subsequent disintegration of Europe's banking landscape. That was the opportunity for banks in Germany and France to divest themselves of Spanish and Italian bonds, and Italian and Spanish banks were told by their governments that they had to buy them back.

So that is just something that happened because there was no proper mechanism in place for the ECB to intervene constructively at that point in time, which was due to the fact that the institutional setup was not complete.

N. Gowing:

Mr. Siyarto?

P. Siyarto:

Thank you, Chair. I would like to touch upon one point that was mentioned about SMEs and industry. What we understood as one of the main conclusions of the crisis is that if you, as a country, do not have a strong industrial sector, then you are not going to be strong in the post-crisis world. So what we are running now in Hungary is kind of a policy of reindustrialization of the country.

N. Gowing:

What does that mean? What kind of industries?

P. Siyarto:

It usually means two dimensions. First, we have totally changed the main values, or core, of the tax philosophy. We have taken away the focus of the tax burden from labour to consumption, which means that we have introduced a flat tax on personal income at 16%, and we have decreased corporate tax from 19% to 10%. Our country is now mainly based on the automotive industry. The other thing that we are doing is that the state is rebuying some industrial assets which had formerly been privatized, in order not to be defenceless; in order to be as strong as possible after the crisis.

Regarding SMEs, we understood that the success of our national economy is mainly based on the success of SMEs. So what we are doing now is running a programme which is called the Strategic Cooperation Agreements with big international companies who are active in operations in Hungary. We try to reach agreements with them so as to involve Hungarian SMEs in their supplier chains as much as possible.

N. Gowing:

That is a minister, a politician, a State Secretary for Foreign Affairs and External Economic Relations speaking. Sir Chakrabarti, you stand back and you make assessments of these kinds of policies. Is that the kind of thing which moves it in the right direction, or not?

Sir S. Chakrabarti:

Yes, I am actually quite intrigued by this approach, so I do not rule it out at all. It does need to be accompanied, though, by the face-to-face contact with SMEs that people forget about when they design approaches. That is what has been missing throughout all these approaches on SMEs, so I would like to see more of that. This is worth taking a look at.

N. Gowing:

Let me move on to bail-ins. I have a point here, made by Damian Chunilal. He says that bail-ins are a bad idea; the fear of bail-ins will result in money leaving banks, as with Lehman in 2008. Letting isolated banks go is fine. In a systemic crisis, bail-in would be very pro-cyclical in practice. Mr. Yakovitsky, what is your view on that? Bail-ins: good or bad?

A. Yakovitsky:

I will answer by looking at what happened in Cyprus. What was initially intended, which, bluntly speaking, was a bit like confiscating property in lieu of payment, and where they actually ended up—shifting the burden and shifting the pain mainly towards the equity holders and the depositors of the bad banks—was, in a way, a recipe. Obviously, that recipe was executed in an isolated, small island system, with a very specific business model. However, whether that is a recipe for too-big-to-fail or too-big-to-bail-in countries in some other parts of Southern Europe remains a big question mark. I would agree, however, that some bad banks will have to fail. That is potentially part of the banking sector restructuring and recapitalization that I was talking about. There may be an execution of that, or hopefully not, in some of the larger economies in the EU.

N. Gowing:

Please put your ideas on the table. I would like to remind everyone that we have 25 minutes left. If there is something that is on your mind and you have a Smart phone or a Tablet PC, please just jot me a note, and then I will open it up. Yes, Dr. Jannelli?

Dr. L. Jannelli:

I would like to emphasize that, from a European point of view, the key issue is not so much ‘bail-in or not bail-in’, but rather if you look at it from a European fissure point of view, what is necessary is the certainty that the bail-in would be the same in all countries. That is the key issue.

I am also not so sure that in Cyprus, ultimately, there were not some depositors that only bailed-in for the very simple reason that the equity funding was very small; that was the issue in Cyprus.

J.C. Cowles:

Unfortunately, it is somewhat binary in terms of the question. You either have bail-in or you have bail-out. If a financial institution gets into trouble, in order to have the financial system continue to work, something has to be done in terms of resolving that financial institution. The public is tired of bailing out financial institutions, so I do not think there is really any appetite for that anymore.

However, at the same time, I would say that bail-in is the appropriate discipline that we should hold banks accountable for. If they know, and investors know, that a bail-in is what is going to happen, if that financial institution gets into trouble, then investors are going to hold that management and that bank accountable to a higher standard of safety and soundness, or else they will not invest in that institution, and its cost of capital will go up.

Bail-in is the way to make sure that there is discipline, to make sure that there is a market force that holds discipline over the financial institutions by way of the cost of capital.

N. Gowing:

Sir Chakrabarti, when you do your analysis, particularly post-Cyprus, would you say that there is greater discipline and awareness that bail-ins can now happen? What is your assessment, three or four months on?

Sir S. Chakrabarti:

Yes, there is greater acknowledgement that that might be the way forward, I agree with Dr. Jannelli there. I would say, though, it is not absolutely clear that that is the way forward. It has not yet been established as a way forward in terms of acceptability across the various institutions.

Is Cyprus a special case, or is it that the new way forward is not yet resolved? I think, like Dr. Jannelli and Mr. Cowles, the bail-in approach is going to be part of the way forward. That is why Slovenia, in my view, is refusing to go down that sort of route.

N. Gowing:

Are you backing that?

Sir S. Chakrabarti:

We are very closely involved with Slovenia’s approach, which is an approach that tries to do domestic adjustments, if you like, without an IMF programme necessarily, but at least with policies that would have resulted in an IMF programme, so that the markets can see that they are taking the same tough actions, without taking the money. That is quite an interesting approach. It is almost like a precautionary IMF programme without calling it that. That may be, frankly, a reaction to the Cyprus approach; they do not want to go down that route.

N. Gowing:
And it is an economy of approximately the same size.

Sir S. Chakrabarti:
Yes, it is quite a small economy. It does not have quite the same stresses in the banking sector, but it has a banking sector which is doubtlessly in serious need of reform. The good thing is that the Slovenians do actually have a reform programme now, which they did not have before Cyprus.

N. Gowing:
Because Mr. Martin Wolf made an important point earlier in the week, suggesting that really, on the political side, the bail-out has been imposed on several countries, really, because politicians felt it was the right thing to do, but actually the reality now is that the way the evidence has mounted is that that probably was not the right thing to do. Mr. Yakovitsky, you agree?

A. Yakovitsky:
As I said, and was trying to allude to, my forecast is that bail-ins will become part of the process. I completely agree with you.

N. Gowing:
As opposed to bail-outs?

A. Yakovitsky:

As opposed to bail-outs. The balance will shift, I agree with you on that. I really want to have the same rules for everyone. My prediction is that we will not, and that things will continue to be addressed on a case-by-case basis. It is as, you said, down to politics and political considerations, which may actually be different in different countries at different times. But bail-ins will be there.

N. Gowing:

Anything more on bail-ins, anyone else want to contribute on bail-ins in the audience? No one at the moment.

Let us move on to banking union, which Sir Chakrabarti put on the Agenda. The idea that it has got to be proceeded with expeditiously. Do you think there is an irreversible move in that direction, or are there still anchor chains which are dragging it and slowing it down?

Mr. Cowles, you are smiling.

J.C. Cowles:

We will move in that direction. As you said, it is a question of how long will it take. There are obviously a number of issues within various countries, in terms of whether or not coming up with a mechanism like this is against certain countries' constitutions. There are certainly issues within certain countries, in terms of what to do with banks within their geographical boundaries; how should they be treated. There are a lot of issues to work through. For example, how can we establish a uniform banking union? I do think, however, that that has got to be the direction to go in. I would maintain that the sooner we can do that, the better off the banking industry will be, and the better off the economies will be across the EU.

N. Gowing:

Minister? You are nodding in agreement.

P. Siyarto:

We are, of course, in favour of a deep integration of the European Union, in every way, because we think that one of the most important elements of the response to the crisis is a deeper integration between European Union countries. But, of course, together with banking union, we have a lot of elements and details that need to be clarified before we are able to issue a final verdict, or final opinion, on that.

I would just like to put on the table that integration within the eurozone needs to be very, very deep and very, very tight. In the meantime, however, those countries who are as yet outside the eurozone should be allowed a slightly wider dimension of tools regarding economic policy. Countries outside the eurozone should be able to choose economic tools from a wider dimension and to create their own economic policy mixes. A eurozone country does not need the same kind of economic policy mix as a country which is still outside the eurozone and still needs to take further steps in order to get into the eurozone.

N. Gowing:

Mr. van den Hoven, would you like to add on this issue of banking union? How important is it for BusinessEurope members?

A. van den Hoven:

It is very important. First of all, to stabilize the financial sector. As I have already said, we basically have a very fragmented financial services market in Europe, with SMEs in some countries unable to get loans or finding it very, very difficult. This obviously then creates a big drag on growth.

There are, though, some highly technical issues that need to be worked out and need to be done right. For example, the European Central Bank is going to take on a role in monitoring banks directly. This is a new role for the ECB; one that has traditionally been done and will have to continue to be done by member state banking authorities. So there will have to be a greater degree of trust, transparency and cooperation between the institutions, the eurozone member states and the Europe Central Bank on how they are keeping an eye on what is happening in the banking sector. That sounds very easy in theory, but in practice, seeing how all the other constructions of European regulation are put together, it will take some time to build up the trust and transparency that is needed. That will be one of the challenges in itself.

N. Gowing:

Sir Chakrabarti, you have to leave in a moment. Would you like to comment on this?

Sir S. Chakrabarti:

Like all the panellists here, I think we desperately need the banking union to work out. The resolution mechanism will happen in the end, but I am less optimistic that it will happen quickly. I would like it to, but funnily enough, the bail-in approach now is, in a way, taking some of the pressure off, because you have another alternative to play with, for a while at least.

Plus, a stabilization fund is necessary, I agree again, but politically, that is very difficult for the larger countries because essentially you are explicitly saying this is a transfer payment to the countries which are in the South; that is quite difficult to do right now. Therefore, this is going to run for many more months.

N. Gowing:

What is going to be the political reality? A couple of messages about deeper integration, but what about those that are outside? Latvia is about to become the 18th member of the eurozone. What is it going to mean to the other members of the European Union who are not part of the inner core? Is it going to hasten the business of a two-speed Europe?

Sir S. Chakrabarti:

In many ways this is a good question to ask our Hungarian colleague. Many of them will want to see what the rules and regulations are before they jump in. Certainly, that would be my advice because the technical issues are quite important: How much are you integrated? Which policy freedoms will you still enjoy afterwards? Those will be very important.

Latvia is a slightly special case because Latvia has taken on many of the budget policies and many of the structural reform policies.

N. Gowing:
Quite severely as well.

Sir S. Chakrabarti:
And on both sides. So they are probably set quite fair, in terms of joining. Some of the other countries, however, are cautious, and for good reasons, about joining so quickly.

N. Gowing:
You have to leave and go to the Presidential waiting room?

Sir S. Chakrabarti:
It looks like I have to leave, my apologies, I have to leave.

N. Gowing:
Is there anything else before you leave, that you are sitting here thinking, “I wish I had mentioned this?”

Sir S. Chakrabarti:
I will mention two things. Firstly, on de-leveraging, it has slowed down. One thing that we should say is that many parent banks, through this process, have actually behaved far better than many people expected. I have just been to Romania, looking at the Greek subsidiaries there, and it is actually a uniform view that the Greek parent banks behaved very well during this process, which I think is a good thing.
Secondly, my earlier point about trying to find room for at least more infrastructure investment in the public sector is linked, though, to a view that over a period of time, these public sector investments must be in the private sector. I would not simply say: “Let us have more infrastructure spending in the public

sector", full stop, as part of a road map towards privatization of many of these. It has got to be part of a process which does deliver more into the private sector within four or five years' time.

N. Gowing:

So, as you leave, should we still be talking about fissures, or do you think within Europe there is at least a willingness to not just put concrete over them, but to somehow move together the blocks in a way that means that it will be durable?

Sir S. Chakrabarti:

Europe's history is about fissures; Europe would not exist if it did not have fissures. We all learned that at school. But there are now mechanisms and organizations which are trying to cover up these fissures, if you like, in a way which was not the case a few years ago; that is a result of the crisis; it has brought some things to a head. So that is a good thing.

N. Gowing:

Thank you for your contributions.

Sir S. Chakrabarti:

I am really sorry I have got to leave. I have enjoyed this enormously, and it would have been good to answer some more questions, but the President calls, so there we are. Thank you all very much.

N. Gowing:

Thank you. Does anyone know if we are going to see the Dutch Prime Minister? Is anyone from the Dutch Embassy here? You have not had a text or anything?

Let me continue with Mr. Yakovitsky. You wrote last year that the troubles in the eurozone were undermining the European banking system. Do you believe that a corner has been turned, or not, with all these other measures that we have been talking about?

A. Yakovitsky:

I believe it has not been turned, in terms of the banking sector reform. Whether that is the banking union or other steps. I believe, as I said in my initial remarks, that this is one of the decisions that needs to be made and needs to be made very quickly, on what would be the approach and the direction towards the reinvigoration of the European banking system's capacity to provide credit to the European economy. So the answer is no, a corner has not been turned.

N. Gowing:

Thank you. Would anyone else like to come in here with anything else which is on your mind at this point? We have 15 minutes to go now.

E. Sandalova:

First of all, thank you to all of the panellists here, and also the ones that left, for their great input. My name is Evelina Sandalova. I have been part of the Youth 20 Summit for the past couple of days, and I am part of the European Union delegation that was representing the European Union at the Youth Summit with other G20 countries and the six observer countries that we had.

During the topic, quite a lot of issues were raised. Since we are a delegation of the European Union, we were definitely attacked on very many different levels, from social policy optimization to infrastructure, energy efficiency, and, of course, monetary policy and government debt. However, I am going to ask one question directly, because otherwise there are too many to ask.

The measures regarding youth unemployment have already been mentioned. As part of the European Union delegation, I was representing social policy optimization. We raised, obviously, the Youth Guarantee, the dual system of education that we have in some of the European Union member states. We also raised the issue of vocational training. Today we had a meeting with the B20 leaders to present to them our final communiqué and to try to engage the public sector in training for youth, so that we can push for better engagement between youth and companies.

The question is: would the public sector actually be open to that idea and what would be the measures to tackle youth unemployment, especially for BusinessEurope? Thank you.

N. Gowing:
While you still have the floor, do you and your colleagues here, at this conference, have any confidence about what is happening? We heard from the Minister that austerity measures do not work; there really is that kind of scepticism. Do you feel that at least a corner has been turned, or not?

E. Sandalova:
I am from Bulgaria, and I live in the UK. I believe that there is an optimistic future, however, the current measures have not been working properly. That is why, in Spain, youth unemployment is nearly 60% now. When we tried to implement the international-level Youth Guarantee to open up the public sector, they bounced back by saying: “Well, you should do it in the European Union first and try to handle it before trying to implement it on an international level.”

N. Gowing:
Thank you. The public sector: who would like to come in on that? Dr. Jannelli?

Dr. L. Jannelli:
As far as youth unemployment is concerned, it is important to clarify one thing here. We always talk about the youth unemployment rate; we compare it with the general unemployment rate; it always looks dramatically high. Now, I am the last one to not be concerned with unemployment, especially in the periphery economies of Europe, because it is undermining any chance of creating a common identity for Europe, like other regional powers have.
However, it is important to state that across all advanced economies this unemployment rate has gone up very high, if you closely look at the figures across all advanced economies, except for Japan, Germany and Switzerland,

also for the United States and the UK, and the three countries that I mentioned as exceptions.

If you look at the youth unemployment ratio, young people really looking for jobs, it does not look that bad. Why has it gone up that much? It is because of globalization. The middle classes of the advanced economies struggle to keep up their living standards. You see that mean income may grow, but median income is coming down, which means polarization in incomes, so a lot of youngsters keep on studying in the hope that they can somehow keep up with the living standards of their prior generations.

However, this is a phenomenon that is occurring in all advanced economies. It is not quintessentially European. It is a tragedy in Europe, however, because the crisis has exacerbated it in the periphery economies where there is no credit, where companies cannot invest. So in Europe we have a tragedy within the tragedy.

It is important though to state that the youth unemployment rate also includes people who are studying, and that is high in all advanced economies right now.

N. Gowing:

Do we need to be talking about jobs or new kinds of work, to encourage the next generation, whether here in Russia or elsewhere? Minister.

P. Siyarto:

We are coming from the same region, being central Europeans. I have to tell you that Hungary used to struggle a lot with this issue. We had to struggle with a very high unemployment rate that had a high youth unemployment rate within that as well. We have understood that there are two major problems that we have to tackle in order to be able to solve this problem. One was a problem with the higher education system. We trained too many students to a level for which there was no demand in the labour market.

N. Gowing:

Do you mean old-fashioned?

P. Siyarto:

No, we understood that. We now put much more emphasis on engineering, natural sciences and the ICT sector. While we were doing that, in the meantime, we lowered the number of economists and lawyers that we educated and trained. Now this kind of output from the higher education system meets the demand of the labour market much more closely. We also restructured the vocational education system, a dual one, based on the German example, which is now the most successful in Europe.

The second problem that we identified was the tax system. We had a very complicated and very progressive tax system which penalized work. The more you worked, the more you were taxed. If you earned ten times more, you were taxed twenty times more. We understood that a system which penalizes work is totally against the goal of employing more people. That is why we introduced this flat tax, which means that if you earn ten times more, you are only taxed ten times more, which is a reasonable rate, as we understood.

N. Gowing:

Mr. van de Hoven, what is your perception of jobs and work and ways of earning money in the future?

A. van den Hoven:

This is an important point on youth unemployment. It is one of the rare areas where our organization and the trade unions are actually working together really cooperatively to try and solve some of this.

There is the Youth Guarantee scheme that you mentioned, which we are both working on and are supporting more or less with some detailed changes. The only problem that we have is that we also say, and we have some support from the trade unions on this, that this also needs to go hand in hand with labour market reform. As you know, in most European member states, we have labour markets that protect older workers and keep younger workers out of the market because companies are afraid to hire them for fear of not being able to let them go if the economy goes into a nosedive.

That is one of the problems with the Youth Guarantee. It provides a tax break, basically, for a short period, but employers are not going to hire young workers if they do not also have the flexibility from the labour law side.

Another thing is, as my President has also pointed out, that if there is no growth in Europe, the Youth Guarantee cannot assist in encouraging youth employment, tax break or not. So this is another factor that needs to be looked at. We need a growth agenda. An infrastructure with private sector funding is the big one.

Finally, and here again we are working cooperatively with the trade unions on training, in Europe most of the countries that have dual learning vocational training systems have a significantly lower youth unemployment rate than countries that do not. In Europe, we need to do more on learning, observing who does it right. Most countries in Europe used to have dual learning systems but got rid of them about 20 years ago, when it was unfashionable, and they have much higher unemployment rates now. So we are going to push for the reintroduction of dual learning systems in those countries that abolished them, to try to bring those unemployment rates down.

N. Gowing:

Let us get another point from the audience, please.

From the audience:

Thank you. I am representing a non-EU member country banking sector, but looking to the EU banking regulations.

N. Gowing:

Which country?

From the audience:

Armenia. My question is very simple. I have worked for the European Union for a long time, and I have serious doubts about the capacity of the European power and authorities to make a proper decision, particularly when we are talking about banking. After the post-crisis fears on issues related to Basel III, now the European Union is facing the problem of the recession and the necessity to pump enough laws and credit into the economy, at the same time making this credit more expensive through the implementation of Basel III.

Just a couple of hours ago, the former Singaporean Minister of Finance said that you are exchanging a focus on specific problems for a long-term vision of the potential threats of the crisis in the future. How do you find the solution? I think it would be better to let the banking sector find an answer to deal with that. How can we deal with Basel III and carry out the needs of the economy with regards to credit?

N. Gowing:

Mr. Yakovitsky.

A. Yakovitsky:

Given that I did some work on this one, the easiest solution here is to work on the timing mismatch and potentially look at some of the specifics of the Basel III introduction; make an adjustment, have a longer road towards it, and simply be practical.

People who big-picture design these things have to really understand how a specific provision in Basel III is going to impact. Whether that is on SME lending, whether that is some other aspect of what bankers do, in a given year, in a given country. That type of granular work has not actually been done. The European crisis will hopefully force people to do this and move to Basel III in a far more growth-supportive and growth-enhancing way.

N. Gowing:

Mr. Cowles. Still concern there?

J.C. Cowles:

Yes. I would say two things. Basically, what you are talking about is the cost of credit for the consumers of credit. If you have Basel III, is that going to increase the cost for the corporation, or the individual, whoever may be borrowing?

With any of these problems, the thing that we are seeing is that obviously there is not one solution; there are multiple solutions that we have to look at. I still would maintain that under Basel III, it is important for banks to clean up their balance sheet; it is important for banks to go ahead and reduce leverage; to come into a situation where, under Basel III, they are considered to be safer and more sound. If they are safer and more sound, eventually they will be in a position where, after they have deleveraged, they will be able to grow again and their cost of capital will come down. If their cost of capital comes down, then they are going to be able to provide capital to their customers and their clients at a cheaper price.

The other thing I would say is that within Europe, and within the EU, the other thing we have to have, and it is one of the things that you referred to earlier, is less dependency upon banks for borrowing. We have to have corporations be able to access the credit market, and we need to have the credit market more fully developed within the EU going forward. If you take a look at the United States, about 70% of debt financing for corporations is provided by the credit markets and about 30% by the banks. In the EU, it is about the reverse of that.

It is important to continue to develop the public credit markets in the EU so that you do have that access, and you do have that alternative. Unfortunately, things like the Financial Transactions Tax (FTT), which is being proposed, potentially put an issue on the table which is going to stop the credit markets and stop other financial instrument markets from developing as quickly as they should.

N. Gowing:

Let me just go to Mr. Yakovitsky finally. Looking at the paper that I received beforehand, you are still quite gloomy about where ‘flexterity’, as you put it, is moving. Austerity with a bit of flexibility. Maybe too much time to meet some of these targets. For you, as a banker, looking at the options on the table; looking at fissures, and how long they are going to last. We have now heard that QE3 in the United States is likely to end by the middle of next year. At least that seems to be

Mr. Bernanke's signal, whether he is there or not, from yesterday. Overall, what is your assessment, therefore, of whether the gloom can move a little bit into rising towards brighter shafts of light, or not?

A. Yakovitsky:

Even though I have sounded gloomy, I am actually fairly optimistic, because ultimately, as I said, my biggest concern with flexterity on the one hand, and austerity on the other hand, is that there is not enough burden sharing. If Europe is to maintain itself as a single union, this burden sharing has to happen. My call would be that it will. There is a lot more at stake that will ultimately outweigh the nuances of the fiscal policy and the balanced budgets, but that is more of a political thing.

So I am actually optimistic but there is a long road ahead. The reason is that there is no easy solution. It is going to be very tailor-made. Unfortunately, in many countries, it will take quite a number of years to get there. Growth is the most important thing. Without growth you are simply increasing your debt and shrinking the economy.

N. Gowing:

I would like to convey the apologies from the Dutch delegation. The Dutch Prime Minister has not been able to get here from his meeting with President Putin. May I ask one of our politicians on the panel, therefore. Secretary of State: how well do you think the European political class can cope with that? There are two or three questions here concerned with the fact that the political class is still struggling with the reality of the unknowns being faced by Europe.

P. Siyarto:

I would like to draw your attention to the Hungarian solution, if I may. We have been under very serious economic attack over the last two or three years, challenging our decisions at an EU level. What we understood in 2010 was that if we did not fulfil burden-sharing, then the country would not have been able to come through the crisis.

We have introduced some decisions which were attacked by major economic players in the European Union because from our point of view, burden-sharing meant that we must not put all of the burden on the shoulders of our people.

What we did was involve big economic players in averting the burden. We put crisis taxation on the banking sector; we put crisis taxation on the energy sector, of which the average burden of corporate tax was 4.6% in Hungary during the crisis; then we put a special taxation on retail and telecommunications. With this, with fiscal discipline, and cutting the political elite in the country by half, because we had 386 Members of Parliament and now in next year's election we will vote for only 200. Before, there used to be sixteen Ministers and now we only have eight. With fiscal discipline and with burden-sharing we were able to overcome the crisis in Hungary.

N. Gowing:

What are the opinion polls showing about your popularity?

P. Siyarto:

We are up by far.

N. Gowing:

One final thought from the audience: are scientists researching the possibility of stopping time, so that the EU can find the time to get its act together? That is from Alexei, via Twitter.

Can I thank you all very much indeed for this rolling conversation we have had, with people arriving and people departing. Thank you very much for your participation.