# BRUSSELS FORUM 2009

## *Fiscal Policy After the Financial Crisis*

### Philip Stephens

#### The Financial Times

[Audio in progress] We thought we'd end the Forum on something, with something light. Discretionary stimuluses, non discretionary stimuluses, effect on pension funds of unsustainable budgets and the rest.

We've got a very distinguished panel. I'm not going to go through their biographies, but I'll just introduce them briefly. Joaquin Almunia, Commissioner for Economic and Monetary Affairs at the European Commission, a lawyer and an economist I think.

We have Senator Bob Bennett, Robert Bennett from Utah who serves, among other things, on the Joint Economic Committee of the Congress. We have a very distinguished, as we heard, Jean Pisani-Ferry, Director of the Bruegel Institute, one of the best - and I say that as a consumer of these things, one of the best think tanks in Europe. And we have Axel Weber, the President of the Bundesbank and a member of the ECB's Governing Council. So all the expertise that you need in four chairs just here.

Now before I start, I just want to make a small confession. Because whilst some of you perhaps, were having a nightcap last night, or enjoying the late night debate in the bar, I was reading something called 'The State of Public Finances, Outlook and Medium Term Policies after the 2008 Crisis', and this was produced the other week by the International Monetary Fund.

I recommend it, not just as a sedative, (laughs), but also as a serious document which for me made me realise how quite a lot of the things that have been written and said about this debate haven't really been grounded in facts and figures. We all know about lies, damn lies and statistics, but there hasn't been, I don't think, a great deal of clarity in the debate and lots of things have been said about how different countries are behaving, which aren't quite true.

I will give you a small example. One of the things that shocked me as a European is if you look at these numbers, Germany's discretionary stimulus, the amount it's putting into its economy, is twice the level of France's. Now that seems counter-intuitive because Germany has been getting quite a lot of opprobrium for its position. So I think one needs to be careful with some of the numbers and the assumptions.

That said, two tensions come out when you look at the documents and look at the figures closely. The first is the tension that runs through this crisis, and that's the tension between the short term and the medium term. Lots of things are very sensible to do in the short term, to try and get our economies out of this mire, have very bad medium term consequences. So the trick, if you can call it that, for policy makers, is to strike the right balance between doing important and necessary things now, but not ruining their economies for the next two, three, five years.

I think the second thing that comes out is this difference between the way the United States is behaving and European. It's not quite as big as it's been suggested, but it seems to me an almost cultural one. And I was thinking of someone coming across a train wreck, and what I think the American reaction to a train wreck is to pull the train off the track and put another one on. What the European reaction, I think is, to a degree is well get the train off the track, but lets work out first how we can stop it happening again.

And I think some of that cultural difference comes through. But I'm going to stop there. I'm going to start with Mr Almunia and I'm going to ask him, is this bashing of Europe for being too slow, too reluctant to push out its budgets now, is this justified? And also how is Europe going to strike this balance between the short term imperative to get economies moving and the medium term risk. If you look at a lot of European countries, their debt positions look pretty tough in the medium term.

**Joaquin Almunia - European Commissioner for Economic and Monetary Affairs**

Okay thank you very much, good morning.

Well I think Europe is doing what should be done. We decided as Europeans, the 27 member states, to give to our economy discretionary fiscal stimulus around 1.5 of our GDP. This decision was adopted in December, now its being implemented. We are, roughly speaking, this stimulus should be adopted not only at the European level, but mostly at the national level by the different governments and parliaments of our members. This stimulus, broadly speaking, has been adopted, is being implemented, we need to monitor.

We said that this stimulus should be timely so as to have effects now that we need now. The stimulus targeted to be efficient, not to use the public money in inefficient areas or sectors, and temporary and this links with your second and big concern, how we will withdraw this stimulus and how we will pursue a strategy of budgetary discipline of fiscal sustainability over the medium to long term.

And right now we know that the increase in public debt in liabilities, contingent liabilities or explicit liabilities for the next years in Europe is huge, as it is the case in other countries of the world indeed. We have problems in countries, European countries that did not consolidate their public finances before the crisis. I can give two very well known examples, Greece and Italy was the public debt to GDP ratio before the crisis was around 1% of GDP, we are concerned by the situation of some countries who's public debt is increasing very very fast because of the efforts needed, not only for fiscal stimulus, also to support the banking sectors. And the amount of resources committed for the support of banking sector is huge in Europe and in the EU.

And we are, of course, as you are aware , that in the next decade we will be facing aging, and the consequences of aging on our public finances is well known. So we need to have an exit strategy, we need to have the political commitment to withdraw the stimulus, the fiscal stimulus and also the monetary stimulus that Axel will talk about this indeed.

Once the recovery will start, we cannot afford to spend the next two decades absolving the debt that we have created to tackle this very deep recession.

We have a very good instrument for this. In Europe we have this fiscal framework, the Stability and Growth Pact, the way to monitor, to give surveillance, to send recommendations to the member states so as to pursue medium term budgetary strategies that are sustainable and long term budgetary and fiscal strategies that are sustainable.

I think this cooperation in a system where budgets are de-centralised is really extremely useful. It was useful to create the euro and to reap the benefits of the euro in the first decade, and I am sure that will be extremely useful for the next years.

**Philip Stephens**

Thank you. Senator Bennett if we sort of move across the Atlantic. If you look first at what the Administration the Congress is doing in Washington in terms of a very big stimulus, racking up very large deficits, are you getting that right in terms of focussing on the here and now, rather than the two, or three or four years down the road? And is there a credible plan as it were to get the United States back on balance, or should we forget about that for now and just get ourselves out of the hole that we're in?

**The Hon. Bob Bennett - US Senate Member**

Well first let me lay down the caveat that you are asking a Republican.

**Philip Stephens**

Of course

**Bob Bennett**

And there were not very many Republican votes for the stimulus package.

**Philip Stephens**

Yes.

**Bob Bennett**

So I think it is safe to say though that there is significant difference - there are significant differences of opinion among economists, not just along partisan lines, about whether or not this is going forward in an ad hoc manner or whether its going forward with a thoughtful long term fashion. And obviously from my point of view, I think there's been a lot of ad-hocracy going on with respect to this.

I do believe that we need a large stimulus and I am prepared to vote for a large stimulus, but the temptation when you're dealing with the American Congress, the temptation to put something on the luggage car of a train moving the station, is irresistible. And when you look at the stimulus package, particularly as it came out of the House, you see I sit in the Senate so its easy to bash the House, if you look at it particularly as it came out of the House it contained a whole series of things that have been on the agenda of the now majority party, for a number of years, regardless of the state of the economy.

That those of us on the other side of the political divide say are not stimulative at all. And they will simply add to the national debt long term, raise the baseline for future budget calculations and create a larger debt problem to have to deal with in the long term, then the stimulus alone would be there. That is the core really of the debate that's going on in America right now about this.

Everybody believes there should be a stimulus, but the make up of the particular items that go in there is what's causing the problem.

**Philip Stephens**

Just so I can be clear, in terms of order of magnitude, you're saying that the Republicans are on the same side as the Administration.

**Bob Bennett**

I'm not sure we're on the same side as order of magnitude either, but we are on the same side that there needs to be something, we're willing to accept a very significant deficit this time. Now the deficit is coming out, depending on whose score you take at 8.5%, 10%, whatever of GDP and the United States has never run a deficit of that size outside of wartime, so you've got another bunch of economists who are coming forward and saying that's very dangerous.

Now the one thing that I have learned, with absolute certainty - this one I know I will not be proven wrong, all of the scores, all of the budget figures dealing with the future will be wrong. Every time there is a projection, it is always wrong. Sometimes its on the high side, sometimes it's wrong on the low side.

A variety of reasons for that, we know what we can spend. We do not know what we will get in. Money does not come from the budget, money comes from the economy and the economy expands or contracts in ways that are impossible for the computers at CBO to second guess.

So whatever figure is being put forward as to the size of the deficit it is wrong. Whether its too high or too low, we'll have to find out. And that makes the future even scarier. Because right now, we are looking at a deficit and as I say the building of the baseline on which further appropriations will be made, that the United States has never had experience with before outside of wartime. And wars you know are going to end, whether this recession or depression, call it what you will, is going to end yes. When, at what price, the scores are all wrong, we're all getting into a [terror incognito] here, and so right now there is a sense of false security because in the situation where the world is as uncertain as it is, there is a flock to the dollar. The Treasury auctions are over subscribed, people are basically paying us money to keep their money.

That is there is no real interest value whatsoever. That will lead you into a false sense of security with respect to how you are going to finance this. Because that's clearly not going to be the case a few years from now, and if there is a flight from the dollar and a fear that the Americans are in too deeply, then in order to get people to give us the money we need to finance our debt, we will have to raise interest rates as dramatically as we have now cut them and in that prospect we could be facing a runaway inflation that could be very unhappy indeed.

**Philip Stephens**

Okay, thank you. I'm going to turn to Mr. Weber. I really want to put two questions. One, is this sort of bashing that we see, certainly in sections of the press, but also among other politicians of Germany as being too cautious, too slow. Is that fair, well I don't suppose you will say it's fair - but explain why its not unfair.

And could you tell us also how what governments are doing fiscally is influencing, perhaps, what the ECB is doing on interest rates. Because one of the striking things is if you look at the United States, its effectively zero interest rates. If you look in my country it’s effectively zero, there's this funny thing called 'quantitative easing' going on around on both sides of the Atlantic in the US and UK. The ECB rates are still

1.5%. ECB seems a bit more cautious. Is it trying - is it worried about the fiscal position? Does that have some influence?

**Dr. Axel A. Weber - President, Deutsche Bundesbank**

Well the first thing, let me also say hello to everybody and I'm pleased to be here.

The difference you keep forgetting is that whilst rates are at 1.5% in the euro area and heading down, short term rates are way below our policy rates by now, because we choose a particular modus of credit giving bank liquidity, which means that short term rates are below 1%. Actually inflation in the euro area is just coming down to 1%, it's not at zero like in the United States, so the real rates are actually no different neither in the short term nor in the medium term in the euro zone relative to the US.

So in terms of monetary stimulus I think we've put in as much monetary stimulus in a short period of time as Central Banks both in the UK and in the US.

The second issue, let me come back to this issue about whether Germany has done enough. I think the whole perception and the whole debate was about four points. The first one is Germany was perceived as having more room to manoeuvre relative to other countries in the EU.

Well we reached a balance budget in good times, which has been the medium term orientation of our policy all along.

Having tightened up fiscal expenditure, and having consolidated, means that we had more room to manoeuvre indeed and our package is larger than the package of many other countries. I don't want to go into examples, but there are other large European countries that haven't put a discretionary fiscal stimulus in that was as large as ours.

Second issue is in terms of what the German Government has done, we have to keep in mind, and this is a cornerstone of German policy responses, if you respond to a crisis in the short term, a credible commitment to not moving to an unsustainable position in your crisis response is a sine quo non condition for having an effective crisis response.

If the German people were to believe that our fiscal response would jeopardise the long run sustainability of fiscal impulses, they would move to more precautionary savings, rather than using the fiscal stimulus to basically foster demand.

**Philip Stephens**

What you are saying is it would be ineffective because it would be wiped out by extra savings.

**Dr. Axel A. Weber**

It would be totally ineffective and that's what you see in some countries, where the sustainability is much more of an issue because capital markets keep penalising unsustainable long term positions, then I think you have a difference in the - but that's something that is deeply rooted in our policy framework, and I think it comes from the fact that we have a more long term orientation, even in a short term crisis response.

The feeling sometimes is let’s have a short term response and let’s worry about the long term once we are done with the short term stimulus. It's in my view a totally wrong view of crisis response.

Crisis response does have to be temporary, targeted, and it also has to be at the same time, measured and medium term orientated. And whilst everybody talks about the three T's there's three M's which also means it has to be meaningful, that would be a third condition.

I think the German response has been meaningful, it was substantial, it had never lost out of sight the medium term orientation and I think it was measured in the sense that it was sufficiently front loaded to have an effective crisis response at the point in time when the economy turned down.

But to go into, or to create the expectations that our crisis response can prevent the downturn, I think is creating wrong expectations on the side of the public. At the most, and we should be frank about this, at the most we can mitigate the downturn. We will not be able to prevent it, nor in my view, should we come to a situation where we jeopardise public finances in such a way that the sustainability is questioned and therefore the short term effectiveness is questioned as well.

So I think that that is an important consideration when you talk about fiscal response. And on the monetary response, I think you also have to see systems across the Atlantic and in Europe are different.

We in Germany have a very profound unemployment scheme, we have a health scheme that is very much available for everybody, with a high level of health quality and quantitative measures for everyone. We have not just pension and health but we have social security systems in place, all these things in a downturn help to mitigate the effects of the downturn which we call 'automatic stabilisers' in economics, and it’s very often forgotten, if you just look at the discretionary policy on top of these automatic features of mitigating a downturn, you very often compare two different things.

US has much less built in stabilisers, so the discretionary response needs to be much more substantial in an economy like that. Different in Europe, in Europe you have a very - a more balanced mix between discretionary impulses and automatic stabilisers.

**Philip Stephens**

Thank you. Finally, Jean Pisani-Ferry, who as a sort of independent and extremely knowledgeable observer can be perhaps provocative, or I will try and provoke him a little. But first of all, do you buy this that Europe is being responsible and the US is being irresponsible, or are there quite a lot of differences within Europe, some countries being more responsible than others?

And I think when you look at the build up of public debt in some of these countries, and you look at the states of say their banking systems, you begin to wonder about, I suppose, are there European countries that could go bust. Are there countries in the Euro Zone for example, and people talk about Greece and Ireland as potential, that could actually go bust and have to be bailed out in a very significant way and I wonder whether Germany is keeping back some of its money because it fears that it may have to do this.

And are there countries in Central Eastern Europe who have had very rapid expansions, this combination of their banks expanding, a lot of borrowing in euros, are there countries just outside the Euro Zone that may go bust?

**Dr. Jean Pisani-Ferry - Director, Bruegel**

Yes, let me start by saying on the fiscal response in general, that I very strongly agree with Axel Weber. There is no contradiction between giving stimulus now and having a strong response to the crisis now, and having a strong commitment to repaying the damage in the medium term.

And in fact you need both and the more you're credible in the medium term, the more you can do in the short term. And this is especially relevant now as we see that we are not going to go out of the crisis in 2009 as expected at the time when the stimulus was launched, it's going to extend to 2010.

We basically don't know for how long it's going to last. And we don't want to remove the stimulus too early. This is what the Japanese did in 1997, yes 1997 and that was then the economy collapsed.

So we have to keep the stimulus, and the more we go into that, the more we go into debt and the more there are questions about the medium term. So we need this strong commitment.

So what's the situation we have. I think in the US there is a strong response and a very weak commitment towards sustainability in the medium term.

And in Europe I think we have a weaker response, a weak response. I would say less than 1% of GDP as a discretionary stimulus, against a drop that we can assess in 2009 to be from 2% growth to minus 3%, that's 5% so that means at best we are responding one fifth, that's mitigating to a very limited degree.

And as regards medium term, I would not say that we have a strong framework. The stability package is not a strong framework. It's not strong enough and we are going to discover again and again that in fact we would need a stronger framework for the medium term, at the EU level and at national level because we've seen countries after 10 years in the euro still having fiscal positions that are not satisfactory.

We've seen Greece having 3.5% budget deficit after several years of high growth, so in this respect the stability pact did not operate as it should have been. And on top of that the stability pact has in fact neglected other vulnerabilities that we have discovered at the time of the crisis.

I think a country's positions could deteriorate extremely fast because they were in fact, implicit liabilities that were not taken into account.

So I think we need a stronger commitment to the medium term.

Now to come to your second part. That's also why we are finding some countries in difficulty. Basically the aggregate public debt is the same in the US as in Europe. But in Europe we have diversity so we have countries with public debt above 100% and with weak response in terms of correcting this situation. So markets have started to worry, we see that on the price of debt for Greece, for Ireland and we have to imagine what the crisis could be.

And the crisis is possible in the euro area, that would be funding crisis, that would be simply that a state will face increasing difficulty to borrow and at some point the market will not be -.

**Philip Stephens**

A lot of people say that Ireland perhaps could go the way of Iceland.

**Dr. Jean Pisani-Ferry**

The Irish problem is not a problem of having had wrong fiscal policy before, they had 25% public debt, percentage of GDP. But the size of the financial problems, the size of the needs to rescue the banking system are such that they were.

So what should we do if this happens, and this can happen, the question is normally you would call the IMF, that would be the normal response. It has been said by Joaquin Almunia and others that there will be a European solution.

The problem is the credibility of the European solution. Because we know that the IMF is tough, we know that the IMF has the technology, they know that the IMF can accept to see people in the street burning the flags with the IMF on it, the question is whether Europe has, the EU has also the capacity to do that.

**Philip Stephens**

Yes, I'm just going to press you before I open this up to the audience. I was talking to someone here in the European Council who, a couple of days ago all 27 Heads of Government came into town and had their meeting to coordinate positions for the G20 meeting in London, and this rather, I suppose slightly cynical diplomat or official said 'do you know I've just sat through a European Council where 27 leaders spent three hours arguing about GBP5 billion in expenditure.

**Dr. Jean Pisani-Ferry**

Euros in fact.

**Philip Stephens**

Euros, yes. It doesn't fill one with confidence about Europe's coordinated response. But I'm going to throw it open now.

**Joaquin Almunia**

Philip I have one comment to your last remark, because I was there.

**Philip Stephens**

Well so was this person who -.

**Joaquin Almunia**

They were discussing about many other issues, much more important than the EUR5 billion. They agreed also in the EUR5 billion.

Some media -

**Philip Stephens**

Well I'm not going to go - I'm not going to have an argument.

**Joaquin Almunia**

Not your newspaper but some media, the day before said well they only worry around EUR5 billion, simply it was not true.

**Philip Stephens**

Okay, well I'm sticking with what I was told.

**Joaquin Almunia**

We agreed a loan to the IMF of EUR75 billion, they agreed on the extension of support to non euro members with problems to a ceiling of EUR50 billion, they agreed on the common position of the EU countries, vis-a-vie the London summit.

**Philip Stephens**

Okay. I'm going to ask - we've got a lot of different issues on the table. Feel free to address any of them and all of them. I do, if I can I'd like to provoke some debate between Europeans and Americans. So I will start here.

## *Q&A Session*

**Jim Kolbe - Senior Transatlantic Fellow for the German Marshall Fund**

Thank you very much and I think this is a very distinguished panel that's obviously - if everything in the world of finances were in these hands we'd probably be a lot better off.

As, I'm sorry, I should have said I'm Jim Kolbe - Senior Transatlantic Fellow for the German Marshall Fund, but also have served for 22 years in the US Congress.

And in my service in the Congress the one thing that I specialised on much of the time, Senator Bennett knows some of this, that was trying to get us to look at the long term of things like social security, Medicare and the things that have the long term impact.

What really concerns me about what's going on now with the stimulus is how little we are talking about what are the longer term consequences of this. How, it was addressed by the Commissioner and the Central Bank, but how are we going to finance these in the long term. What is the consequence, the economic consequences of the amount of deficit financing we are adding here in Europe in the United States, that becomes built in, the interest costs of that get built into the budget. What kind of a drag is that over the long term for the economy?

And so I guess my question is that is are we doing enough thinking about that in the long term and even more specifically are we trying to make the publics understand the consequences of this and get them to deal with it because my great dismay in the United States is we never think really beyond the next election and nobody really thinks in the long term. And I'm very profoundly discouraged about the prospects of this if we don't start thinking a bit more long term.

**Philip Stephens**

If it's not a term of abuse that sounds a very European way of looking at it. But I'm going to take one or two more before coming back. This gentleman right there at the back.

**Darrell Issa – US House of Representatives**

Both of our countries have said that toxic asset were the big problem before stimulus was even proposed in the level that we're now talking about. In the last few weeks we've all seen on the news the $175b either given or pledged to AIG. In the opinion of this panel if we continue to give money to the underlying insurance, in other words by giving to insurance we say there'll be no discount on toxic assets, they're going to be insured to 100% which has been the American strategy even though the Americans originally said they were going to buy the toxic assets at a price higher than their market but lower than the original face value. Both from a European and a US strategy should we go back to essentially buy at a discount to original and a premium perhaps to market? Or should we continue the strategy that the US has been doing so successfully so far? Yes that's supposed to have been a laugh line. Which is buying the insurance thus guaranteeing 100% of an unknown amount. And by the way, I was supposed to say it first but I'm Congressman Darrell Issa from California who voted against the TARP in the stimulus just in case you're wondering.

**Philip Stephens**

I'm going to open it but I just wonder is there someone from the United States here who's actually in favour of the stimulus and the TARP and would like to -- and will admit it. Getting no takers. Yes okay. And then we'll move to the panel.

**John Kornblum - Chairman, Lazard & Co**

I'm John Kornblum from Berlin but I'm an American. First place I'm one of the probably 99.9% here who would admit that it's hard to figure out what you're for and what you're against. But what I wanted to say is that I think that what we have here, and it's almost a case study for all of the US, the experts at Atlantic relations here, is a classic clash of cultures. And I think it's especially important for Europeans to understand and to examine very carefully what the President is trying to do and what his needs and requirements are. I've followed the European discussion fairly carefully and I don't think that's taken place. The President has got a bunch of smart people who are coming up with a program which hopefully will succeed.

But at the same time he is facing a true firestorm of public anger over the financial community, set off in particular by the bonuses to the AIG company. And I was looking, as one can these days, I was looking at the American press this morning and the people like Frank Richard in the New York Times are already saying this is one of the President's major challenges which he hasn't met yet. So he's under tremendous internal public pressure which may not be good for the long term. I'm not saying it is. But it's important to understand that he's under tremendous public pressure to demonstrate action and competence very fast.

Thirdly, and one can debate this but at least it should be seen as part of the picture, he has presented his stimulus program also as a part of his program to remake America. And so he is connecting the stimulus program with some medium and long-term goals he has in energy and education and healthcare. This may be wrong but again what I'm just suggesting is that it's very important to understand where he's coming from politically.

**Philip Stephens**

Okay. So three sets of questions there. America's not thinking enough about the medium term to long term, we still have a lot of problems with toxic assets and there's this political uproar about AIG and the rest. So Senator, in a sort of bi-partisan, non-partisan way, how do you put all this together?

**Bob Bennett**

Your intermediate question between the two interventions, is there anybody that's in favour of the stimulus. I'm in favour of the stimulus. But I think the Ambassador's comment is right on target. When I said there were a lot of things added in the House they were not added for stimulative purposes, they were added for policy purposes to use the Ambassador's phrase, to remake America. And quite frankly without any kind of hearings, without any kind of significant debate ideas that have been on the table for years that have never been able to get traction in the American political system got, as I say, thrown onto the luggage car of the train as it was leaving the station.

So you find someone like me in great conflict here as I think we need stimulus, we need a big stimulus. But an awful lot of these things are neither targeted nor temporary. They are very much long term changes and they're going to be very expensive. And to Jim Kolbe's point, they do not address the long-term challenge that America has with respect to its entitlement spending. They simply add to those things and say we're going to deal with that somewhere, some time. When I talk to my Democratic friends, and if I may I have a solution to the social security challenge which has been scored by the trustees in the social security administration as a 100% fix. And every time I talk to my Democratic colleagues and say will you help me because Mitch McConnell says we'll get behind you as soon as you show up with one Democratic co-sponsor, they all say yes Bob, this is great, we will help you right after the next election. And Jim's point is the next election never comes.

So I think the three comments have appropriately identified the challenge that we have in America but I give the President and his economic team credit for being serious about this and attempting to come up with a serious solution. But I give his party less credit as it moves through the congressional process, probably with the encouragement of the President, for taking advantage of this or attempting to take advantage of this for other agendas which end up threatening both the long-term stability of the economy and screwing up the support for the stimulus by adding extraneous items to the agenda. It is a very, very predictable kind of political ploy but that doesn't mean it's going to work.

**Philip Stephens**

I think what we're beginning to see here is that the parody of a Transatlantic divide with America on one side and Europe on the other isn't true, that there are differences as we've shown within the United States as much as between Europe. But Jean Pisani-Ferry, how together is Europe as it were on this issue? There's something at the summit, produce something which can be presented to the G20. But in terms of is my country, Britain, on the same wavelength as Germany? Where's France in this? How coherent is the European Union in its view of what's being done and what should be done?

**Dr. Jean Pisani-Ferry**

On this fiscal response, clearly the response had to come from the member states, not significantly from the EU budget. And so the Commission proposed, as Joaquin Almunia said, order of magnitude. And then each and every member state came with its own plan. And if you look at the plans they are very heterogeneous, not only in terms of size as we said but also in terms of priorities, in terms of content. The UK has made a choice of supporting consumption, 100% almost. France has made a choice of supporting investment, almost 100%. This is not really compatible because if the UK supports consumption basically they support also the consumption of imported goods and the implicit assumption in the choice of France and some other countries is that you don't want to support through the stimulus the consumption of imported goods. So it's not going to be a very coherent and very lasting response.

Also if you look at what is the content, exactly the same debate you're having in the US. If we look at what's the share of innovation, we pretend that our priority is to go for innovation, for improving productivity in the medium term. What's the share of it in those stimulus packages. Very low, difficult to assess, but certainly very low. It's a forgotten part. Because the easy thing to do was to go for construction, to go for things that have a strong domestic content and on which you have some projects that you can go for because they've been under consideration for some time.

So I think in terms of really what is going to be the medium term impact of the stimulus, there is some way to go. And I think we would need -- yesterday Bob Zoellick was saying we need the monitoring. I think we need the monitoring in Europe as to what is being done, not only if I may Joaquin the gift-wrapping that you're doing. That's great, we have the response, here is the gift to the G20. But also much more analysis of the appropriateness of the response on a country by country basis.

**Philip Stephens**

I'm going to let you come back on that in a moment but I want to take one or two more. One here, one there and one there. And then we'll come back to Mr. Weber and Mr. Almunia.

**Erika Mann - Member European Parliament**

Thank you so much. Erika Mann from Germany, Member to the European Parliament. I have one question which affects a discussion which we had this morning about innovation. And there was beyond the point how important innovation is an understanding that probably the fiscal stimulus which are given and the financial support to certain industries may be not the right answers. And this certainly affects the car manufacture if you see what's going on in the United States but it affects Europe if you take Opal for example to a large degree. And then if you take figures into consideration we will have Korean car manufacturers opening plants this year or next year, I don't have the precise data, and they will produce 600,000 more cars. You see Tata, a new company entering European and American market as well. So are we judging actually development-wide, are we not spending money in areas which we will regret one day because we will have not the innovation which we want and new technology and new industries?

**Philip Stephens**

Okay. That's a strong point. And gentleman just there and then one here.

**Tomohiko Taniguchi - Senior Advisor, Board of Central Japan Railway**

Thank you. Tomohiko Taniguchi from Japan which is unfortunately a been there, done that nation in many respects. Detoxification of your balance sheet will continue to be the buzzword for some time which will result in the ever-declining appetite for new loans which will then culminate in missing an important link between the increased amount of base money protected by the central banks and the money circulated in the marketplace which is the M3 into the money supply. How can you do this? That's exactly what happened in the case of Japan post-bubble. You did the quantitative easing by printing money in a massive amount but the money supply did not increase because the real sector was so busy detoxifying their balance sheets. It's likely to happen in Europe and in the United States. What can you do this?

And secondly and briefly to Senator Bennett, you talked about flight from dollars. Where can the dollars go? To the surface of the moon? Euro can replace it. Are you serious about that?

**Philip Stephens**

Okay, that's very strong. And one here?

**Edward Mortimer - Salzburg Global Seminar**

Thank you very much. Edward Mortimer from the Salzburg Global Seminar. I live in Austria. It was an Austrian bank collapse in 1929 which began the Depression in Europe, the Credit Anstalt. We read now, notably in German newspapers, that Austria as a whole is virtually bankrupt because of the exposure of its banks to risk in Eastern Europe. I would like to know whether the panel agree with that and if so whether they think there will be a European solution for Austria or will Austria have to go to the IMF?

**Philip Stephens**

Mr. Weber?

**Dr. Axel A. Weber**

Well let me start by addressing some of the issues that were here. I was first surprised that John and I were fully on one line because we're usually not in our response. But the more he spoke the more I found the differences kept coming up. First thing, you said about the Stability and Growth Pact being not a strong framework. Beauty is in the eye of the beholder and the Stability and Growth Pact, we've enacted in Germany a law for the sub-federal governments to have a very similar framework. And let me say the following. The stability and growth pact worked in Germany because we consolidated and went to zero budget. It didn't work in France, it didn't work in Italy, it didn't work in many other countries. For me that's a clear sign that we shouldn't scapegoat the framework. What happened in these countries were very poor policy frameworks in place in these countries. They didn't do the job. And automatically basically and ultimately when you want to tighten the budget it's up to your own government to do the job. So don't blame the Stability and Growth Pact, blame the governments that haven't done their job.

The second thing is that where we also disagree slightly. You mentioned the IMF being a scapegoat. The IMF was a scapegoat because whenever it moved in and gave money it attached very strong conditionality to this support. The argument that we can't do the same in Europe is simply admitting that we are not able as Europeans internally to ask for the same degree of basically conditionality and attach whistles and bells to these programs that we give intra-Europe than we would if an outside institution were to do it. That's not really an indication of a strong framework.

And the second issue where I think we both disagree is you had this comparison of the 5% delta moving from plus two to minus three. Well let me say the following. Part of the reaction we see now on the business cycle is not what we want to correct. We were complaining for a long period of time that we had a very big global imbalance. Some countries had negative saving rates close to zero, some have saving rates like

Germany or Japan that were 10%, 12%. We're seeing saving rates go up in Germany even in the crisis, more towards 14%, 15%. We see saving rates now at 5% in the US, we see them at 1.8% in the UK. My view is saving rates will continue to go up in these excess countries that have basically excessively relied on domestic consumption.

**Philip Stephens**

I'd like to press you on two points that have been raised in the audience. Is the Austrian banking system bust with all the consequences? Or perhaps I'll leave this one for Mr. Almunia, will the euro zone have to deal with this or will Europe be put in the humiliating position of having to tell members of the euro zone well look you better go and sort that out with the IMF? So if you can answer the first one and perhaps I'll --?

**Dr. Axel A. Weber**

It sounds like a [naughtier] question to Joaquin.

**Philip Stephens**

But if you can answer -- you're right next to Austria, German banking system and the Austrian banking system are pretty closely --?

**Dr. Axel A. Weber**

I see no problem in the sustainability of any European country's federal budget. A federal budget has two sides. It has a spending side and it has a revenue side. If you have a problem with excessive spending, put up revenues. And so basically we are ultimately in the position that sovereign states have the ability to raise cash in their own constituency to an almost unlimited amount. It won't be popular but it may be needed. It's not the best thing to do it in a crisis, you have to do it in a post-crisis response. But I think all this talk of euro area sovereigns being in a long-term problem with fiscal budgets it's just a lot of nonsense. Just because risk premia on some financial markets have gone up for creditors who now ask a higher compensation from these countries if they borrow money to them for me doesn't mean there is any underlying problem. These risk premia are simply a pricing of the so far track record of these countries to move to sustainable positions where the spreads are higher, the track record is worse, the only thing to do is improve your track record and your spreads will go down. There is no sustainability problem whatsoever, it's a pricing issue and we shouldn't overplay this simply because some financial market analysts try to make that a big issue.

**Philip Stephens**

Mr. Almunia, so does the European Union have the resources and the political will to bail out its own members if they do run into trouble? And have we failed to learn the lesson of Japan in the 1990s?

**Joaquin Almunia**

I will try to give you not the answer that you are waiting for but my answer to this question. But first of all let me very rapidly touch upon three points.

**Philip Stephens**

Very rapidly because I want to get back into the --

**Joaquin Almunia**

I fully agree with John and with others that Europe, the European countries, the EU members, not only the Euro area members, the EU members, needs stronger economic coordination. And I think this crisis is showing us how weak has been the efforts to coordinate economic policies that are accepted to be a matter of national responsibilities in many areas but a matter of common concern given the high degree of interdependence of our economies.

So I fully agree with this and I am convinced that from this crisis the economic coordination instruments in Europe will be reinforced at the end.

Second, the question of toxic assets or impaired assets as we denominate it here, because toxic assets are the assets linked with the sub-prime and with the structural products mess. But there are other assets that are at risk in the balance sheet. So impaired assets. We have adopted guidelines at the European level on how to treat these to maintain a level playing field, to try to help member states to find the adequate valuation systems, try to establish a line and what kind of assets will be eligible for this treatment, and opening the different instruments. One instrument can be to insure the assets as the British have decided. Another instrument can be to create bad banks. In some cases some European countries for individual institutions they have decided to go to this instrument of bad banks. In some other cases there are nationalizations, in Britain in some cases to a high extent in some institutions. We have defined guidelines. We cannot oblige one member state to decide how to treat because it's not our money, it's their money which is at risk. But we try to coordinate.

And third, the question of medium to long term, I think it's very important. The other day during the European Council there was a lot of concern about how to find a credible exit strategy to this big effort from the fiscal side, from the monetary side, supporting banking system, institutions and functioning. I think we have some elements of this exit strategy that are going in the good direction and I will give you the optimistic side of our discussions.

**Philip Stephens**

You're allowed to give us the pessimistic.

**Joaquin Almunia**

Today I am optimistic. You are inviting me to be optimistic. We have in Europe a common position for this G20 summit. Our priorities are more focused on regulation and supervision of the financial system. But we are also discussing with our partners in the G20, US, Japan, emerging countries including China, also the stimulus. And on the other side they are putting in the headlines the stimulus but they are also discussing with us the regulatory approach and how to deal with this.

I think 2nd of April we will have a good consensus there. And I think it's a positive, very positive thing. But this is not the only element. Let me tell you --

**Philip Stephens**

I'm going to stop you just there. I'll come back to you because there are a lot of people putting their hands up. I will come back to you.

**Joaquin Almunia**

Let me answer your question. Why don't you want me to answer your question?

**Philip Stephens**

I will come back. I'm just very concerned that time is going and that there are lots of hands. So I was just trying to --

**Joaquin Almunia**

So the question that Axel has not answered, I will want to answer it.

**Philip Stephens**

Okay. We'll come back to that. Because there was one there, one there and one at the back there. The lady at the back. So this gentleman here first. I'm sorry I was not trying to --

**Emmanuel Zingeris - Member of Parliament, Lithuania**

Thank you very much. My name is Emmanuel Zingeris, I am an old boring Member of Parliament from Lithuania Foreign Affairs Committee. So my question will be to [inaudible] like an echo to our economical discussions. We have radicalisation of the societies in the Middle Europe, in West Europe, especially in new member countries. So we should know that if our economic coordination will be unsuccessful the street, the radical street is rising and we have from time to time broken windows in the parliament, we have radical movements from left and right rising. So we should calculate this political horrible result of this economical numbers. So I would like to have only a few words if possible about how to avoid the social by-product of all this mess. Thank you.

**Philip Stephens**

There was a lady back there. And then we'll take you there.

**Eva White - Associated Press**

Eva White from the AP. Is it completely unthinkable that there would be a European-wide stimulus. In some of the countries that we're talking about which have problems with their finances, Spain and Ireland can't afford much of a stimulus so it's all very well for Germany saying it has generous systems in place when Ireland can't afford its social welfare this year. I know this is something that Mr. Almunia and other people have been reluctant to discuss but is this something that will never, ever be on the table or is there some idea there?

**Philip Stephens**

Just here?

**Bruce Stokes - National Journal Washington**

Bruce Stokes of the National Journal in Washington. A question for Senator Bennett and I guess for Axel Weber. Let's assume we're in June or possibly in September and the economies -- European and American economies, the world economy is still doing very poorly and the prospects of recovery seem even more distant than they do today. Would you anticipate at that point, as some people do, that we would get another push for more stimulus in the US and possibly in Europe? But most importantly it seems to me what's the political debate that one has on both sides of the Atlantic? In other words, Senator Bennett, what would be the constraints Congress would try to impose on that added stimulus, assuming that you were willing to go along with it, that you were convinced it was needed? What's the dynamic, the political dynamic that a new request would trigger?

**Philip Stephens**

Okay. I'm going to take two more from the audience and then I'm going to invite you because we've got about 10 minutes left to choose the questions that you want to answer and give Mr. Almunia the time I denied him a moment ago. So we've got just two together there?

**From the floor**

My question is about focusing on regulation. What is the EU doing to socialise with the US partners the need to fight tax havens as not only a way to recover some part of the fiscal means that we need to provide the stimulus but actually to rebuild trust and to actually prevent the kind of social broken bones that has been mentioned here. I say this, I ask this question because I've been raising this and I've been stunned by the absence of reaction on the part of our US partners despite the fact that President Obama while a Senator he actually moved a bill to control tax havens.

**From the floor**

Commissioner Almunia mentioned the coming G20 summit and he said that he expects to have agreement there. But I was struck by the fact that in the discussion so far there was no reference whatsoever to the relevance of what the major partners outside the West in the G20 will do. Is this because they are irrelevant? I'd like to have both an American and then a European view. Of course I'm referring particularly to the major external countries, China in the first instance.

**Philip Stephens**

Okay, thank you. Yes, shouldn't we be talking about China. Well we've got about 10 minutes. So I'm going to ask Senator Bennett to respond to the questions that he'd like to first and then we'll go round.

**Bob Bennett**

Well I've filled up two cards with notes here so let me pick and choose. First I want to make something very clear that I think has become muddy here. And that is that we are assuming that the stimulus is all spending. In the United States roughly 50% of the stimulus is tax cuts. And in my view all tax cuts are not created equal and the tax cuts that are in the stimulus package are not in my view appropriately stimulative. So if I can bounce to Bruce's question, one of the things that I would be proposing if we get there is change the mix of tax cuts. And quite frankly, to be truly stimulative in my view the tax cut should not be temporary, it should be permanent because an investor in a business is not going to make the kinds of investment on the basis of a tax incentive if the tax incentive is going to go away in 18 months. And I think that's one of the problems that you have with the way this thing is structured.

Reference was made to the flight from the dollar. There will be no overwhelming flight from the dollar. There's currently a flock to the dollar that I spoke of. But that is what's holding down the interest rates in the United States so dramatically and that will go away, and we are going to have to fund this thing with higher interest rates on the national debt at some future point, and I think that's very clear.

Now, reference was made to the savings rate in the United States being up, and that's part of the problem short term because the balance that we were involved in was that the US will consume more than it produces. The exporting countries will send us the excess, and then we will pay for it with debt which they will buy. And that is an unsustainable long-term structure, but that's the structure we've been in that has now collapsed.

And finally it’s very, very easy to say we've got to take care of the toxic assets, and I fully agree that if you can come up with a system of valuing them that allows us to do that in an orderly fashion, please share it with us, because that has been the difficulty we have in trying to deal with this.

**Philip Stephens**

Okay, Jean Pisani-Ferry.

**Dr. Jean Pisani-Ferry**

On the US and the EU I think there is a fundamental difference which is that there is a need for an adjustment on the US side on the consumption, the share of consumption that is taking place actually, and that is partially offset by the Stimulus, but that's a permanent adjustment that takes place. The US consumer has to save more, and he cannot rely anymore on the assumption that the price of its assets, whatever the assets are financial or real estate, is going to increase and do the job of substituting saving. So that's an adjustment that is structural.

On the European side we don't have that on the aggregate. We have a growth problem in the medium term that's a completely different problem. We don't have a macro-adjustment for the EU as a whole. We have problems inside, we have countries that have to adjust we have countries with excessive deficits of their current accounts. But that's, in the G20 conversation, that's fundamentally different. I think this has an implication for the way we approach the discussion.

And since you spoke about the exchange rate, I think the one good news is that we, so far, we haven't had major problem with exchange rates. Exchange rates are not part of the problem today. And even with the renminbi now, there is a truce with China which is good news. They might be part of the problem tomorrow if the markets start to speculate that the US response will be inflationary that the European response will not be inflationary, and then therefore they have to consider potential discrepancy there.

A word and a question on Austria by Edward Mortimer, which is I think is an important one. The question here is whether we are going to go through that crisis and in the new member states, the accessible borrowing in hard currency of private agent companies and households, whether this can be solved without some form of debt reduction at the end of the day. And that very much goes with the question you raised about the social consequences in those countries. I think we have to seriously consider this question, and stop denying that it might be possible. And if this happens obviously this raises the question of who will bear the burden of it, can Austria do it alone or the other countries that have heavily lended to the New Member States. I doubt it will be possible.

**Philip Stephens**

Mr Weber, I do want to answer other questions, but perhaps you might want to answer that one, would Austria have to do it on its own?

**Dr. Axel A. Weber**

Well being a member of the European Central Bank I don't want to answer questions for any single member country, except for the way that I see no sustainability problem in any euro area country in terms of fiscal balances. This is hugely exaggerated. I know it's talk of the time, but it's totally and utterly out of line with fundamentals.

Let me add one thing, give you a promise here, I can promise you the European response to this crisis will not be inflationary. That's why guys like me exist. We are independent Central Banks and we know exactly when to start tightening balances. What we see now in the crisis response is not inflationary, because it basically leads to an increase in the balance sheet of the Central Bank in order to offset some of the decline in the balance sheet of banks. And so the outside effect of that outside the banking system on the overall growth, and you alluded to that, of money in the economy, will not necessarily at this stage have to viewed as inflationary. But I can promise you once it starts looking inflationary we will tidy up the mess.

And another very quick response on the question on future crisis management, having been deeply involved in crisis management now for the last one and half years, I think it's fair to say that the crisis response is such that we deal with problems as they come along. And the ultimate attempt is to get in front of the curve in terms of the policy response that we need both in size and both in time limits. I think this is what we are trying to do all along. I cannot rule out if the situation deteriorates further that there will be additional measures that have to be taken. It would simply not be in line with sufficient crisis management to ignore such problems that come along.

But let me also say it's very hard to judge the overall impact that this crisis has had on the real economy. Let me mention that we felt that until the demise of Lehman Brothers that most of the fallout of the US subprime on European banking balance sheets could be dealt with in an institution specific case by case crisis management mode. Since Lehman, basically interbank confidence got totally destroyed. And therefore, we had to supplement this case by case approach with a full systemic crisis response of all authorities including governments and central banks. The Governments have put in bank rescue packages in place that are only less than 50% implemented at this stage. So there is a lot of response that has already been decided on that is being implemented. So I think your question do we have to take new decisions, my view is let's first implement all that has been decided and not yet on the way.

**Philip Stephens**

Thank you, Mr Almunia, the last word.

**Joaquin Almunia**

I go to your previous question. So we are dealing with three crisis and [six] non-euro [countries]. Now, together with IMF we have agreed a program for Hungary that has been updated recently and is going on. We have agreed together with IMF a program for Latvia that will be updated with the new government in the coming days. And we are negotiating, and I hope we will announce an agreement next week, with Romania.

We can expect some more crisis or needs for financial support in the non-euro area members, probably yes. And we are equipped for this with this increase balance of payment facility with the good cooperation with World Bank, EBRD, IMF for sure. And with the support of the [foreign] banks and the governments of the [foreign] banks, and this links with Austria whose government and central bank and private banks are fully committed in participating and helping in these negotiations.

I think we have the instruments together with the increased lending capacity for the IMF that was also agreed recently, and will be formalised in London 2nd of April. We have the instruments to avoid this crisis, to become a default problem, we have the instruments.

In the euro area the situation as Axel said is completely different. We don't exclude problems, we are having problems. We look at the spreads every morning and we know the differences between the different situations in the euro area. But we have instruments in the euro area to avoid even these kinds of IMF problems. We have the political decision to use all of our resources to react in a pre-emptive way and not only when the crisis exists.

Is possible an EU-wide stimulus? I think given the present uncertainty nobody will exclude that further decisions will be required. The other day in the Ministerial G20 and probably in the next [held] G20 the sentence, we are ready to adopt whatever action is possible to react to this slowdown will be there, and it's true. But so far we need implementation and monitoring what we have decided. That is a huge amount of resources and decisions.

And final point China, China is participating in the G20 actively. What they said the Chinese they said first we want to be part of the solution, second we are financing some of you through buying government bonds. We want to have more say, a more influential seat in the IMF. And I think it's an adequate balance of this.

**Philip Stephens**

I have a point I think on that, but I am going to have to close here. I'd like to thank you all. I'd like to thank those of the audience who contributed, commented and asked questions. I've certainly learnt a lot during this session. But this is a debate we can be sure that's going to go on for weeks and months, many months and perhaps years to come. Thank you very much indeed.

**Craig Kennedy – President, GMF**

Thank you. That was really a terrific discussion. I want to thank all of you. I know there are some people waiting for you off that direction. We are now at the very end of the Brussels Forum. One of the things that I've mentioned throughout is the very sound relationship we have with the Belgium Government. I think I'd mentioned on the first night that we have these beautiful pieces of sculpture that are throughout the building that Olivier Strebelle did. And he is with us today. And we are just very, very grateful to have these extraordinary pieces of art as part of this event, it's really made a difference, and we're very, very grateful for you.

[End]