ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM

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ECONOMISTS' WORKSHOP: IDENTIFYING THE KNOWN UNKNOWNS

Securing Global Growth

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2011

With roundtable discussions led by some of the top economic minds from across the globe, this interactive workshop will discuss, debate and seek to identify the key risks and opportunities for the global economy and, in particular, the emerging markets, for the coming year and beyond.

Moderator:

Sergei Guriev, Rector, New Economic School

Panelists:

Alexei Kudrin, Deputy Prime Minister of the Russian Federation, Minister of Finance of the Russian Federation

Brian Leach, Chief Risk Officer, Citigroup

Yaroslav Lisovolik, Member of the Management Board of Deutsche Bank Russia, Chief Economist, Head of Company Research in Russia

Vladimir Mau, Rector, Russian Presidential Academy of National Economy and Public Administration

Roland Nash, Senior Partner, Verno Capital

Takashi Nishioka, President of Japan Association for Trade with Russia and the Newly Independent States (ROTOBO)

Elena Salgado, Vice President and Minister of Economy and Finance of Spain

Aleh Tsyvinski, Professor of Economics, Yale University

Oleg Viyugin, Chairman of the Board of Directors, MDM Bank

S. Guriev:

For those who don't know where you are, this is the Economists' Workshop. We will talk about the known unknowns, the risks we know exist, but we do not know how they will get resolved or realized. We have a very distinguished panel today. But to start off, the organizers decided to show you a very short movie. So we will have some time—about 90 seconds—for people to take their seats. Please start the movie. Thank you. [video]

Welcome to this session. We do not have much time, so I will go straight ahead to the panel, without introducing the panel. Let me set the stage. We brought together a distinguished group of economic academics, professionals, and policymakers to talk about the risks to the global economy. We conditionally divided the group into optimists and pessimists. And as you see, pessimists are outnumbered. This is certainly a very vague distinction, because all our participants will take different <inaudible, no sound, test pattern on screen 15:54:13 to 15:55:00> stands on different issues. I would like to set the stage as it was in the movie: we have a number of known risks and probably some unknown risks. And talking about known risks, what I asked from our participants to focus on is what will happen to the US economy, inflation and the fiscal situation; how will fiscal consolidation happen? If that happens, when is it going to happen? The second issue is, of course, Europe: what will happen in Greece and others with high debt and GDP ratios, how will this situation be resolved? The other main issues, of course, are bubbles in emerging markets. There is now a discussion that money printed in the US is now being invested all over the world and, of course, mostly in the growing markets. And some people say that already the pricing of assets in China and other emerging markets are a bubble. Of course there is additional volatility and energy in food prices. There is the effect of disaster and tragedy in Japan. There may be other unknown issues. We may still see a black swan. And Japan is actually an example of that—something that nobody has expected—as well as the events in the Middle East. And this is where we will start. I will give the floor to each participant first, for about 5 minutes. Then we will have questions from panellists to each other, then we will take questions from the floor, and then at the end we will take your vote on whether optimists or pessimists have managed to convince you of their views on each specific risk. And without further ado, let me give the floor to Takashi Nishioka to talk about the situation in Japan and the effect of the disaster. Takashi, please. I will save time on introducing the panellists for the sake of time, because we are very short. Takashi, please.

T. Nishioka:

It is my honour to speak at this distinguished Forum. Taking this opportunity, first of all, I would like to express my deepest appreciation to the people of Russia and around the world for your kind support given to us after the Great East Japan Earthquake. Today I would like to talk about the impact of this disaster on the Japanese and global economies.

On March 11, one of the world's largest earthquakes, with a magnitude of 9.0 occurred, causing the kind of tsunami that occurs once in a thousand years. As many as 24,000 people were reported dead or missing. The damage to Japanese capital stock amounted to the equivalent of USD 200 billion, or presently 3% of the nation's GDP. As a result, Japan's GDP decreased by 3.7% for the first quarter, converting to an annual rate. However, the reconstruction process is proceeding at a pace faster than expected.

For instance, first of all, reconstruction of capital stock in the disaster-hit area is being prepared by the first supplementary budget, amounting to the equivalent of USD 50 billion. Secondly, supply chains are being reconstructed, while production and exports are recovering. Thirdly, a rebound in consumer spending is gradually taking place. And fourthly, infrastructure is being repaired, such as railways, roads and port facilities. Furthermore, a second supplementary budget is under consideration, amounting to the equivalent of around USD 190 billion. In view of the above, Japan's GDP is expected to increase by 0.3% over the previous year in 2011 and by 2.4% in 2012.

As a good example of recovery, I will tell you about the case of Mitsubishi Motors Corporation. We were forced at first to reduce our production, due to the insufficient supply of electronic parts from Unisys Electronics Corporation, which has the world's largest share in the automotive microcontroller market. Through the best efforts of Unisys and the support of car makers, we expect to achieve our annual production goals in 2011, by fully re-establishing the production structure by September and by increasing production over the subsequent months.

However, there is a concern that Japan may face the risk of power supply shortages during the summer season. An initiative has been launched that encourages companies to save electricity by 15%. Various measures are being taken to get through the coming summer without any planned power cuts. Also, there has been an active energy supply from all over the world to Japan. So I believe there will be no power shortages, nor will there be an impact on the Japanese industries, as a whole.

In the future, Japan may be required to increase the use of renewable energy. However, at present, wind and the solar power generation only account for around 1% of total power generation in Japan. So, the Japanese business community thinks that the future power generation policy should be, first of all, to make effective use of fossil fuels such as oil, gas and coal; secondly, to give nuclear power the position of one of the primary power sources, going further with technological improvements; and thirdly, to secure more renewable energy generation, monitoring technological innovation, and exploring possible costs to this action.

In the meantime, the volume of Japan's trade with Russian peaked to some USD 30 billion in 2008. It declined in 2009 because of the global financial crisis, but in Russia it has returned to 80% of when it was at its peak. Japanese automotive companies such as Toyota, Nissan, and Mitsubishi have been expanding their presence in Russia. In the Russian Far East, there are concrete cooperation projects between Japanese and Russian companies. I firmly believe that in the future, Japanese and Russian economic cooperation will play an increasingly important role in various areas, including automotive, infrastructure and energy.

In closing, I would like to say that we have to learn a lot from our experience of the Great East Japan Earthquake. The issue of information disclosure is one of the areas. Under the extraordinary confusion regarding the nuclear power station, both the directing and handling of information was not done satisfactorily. This has led to mistrust, not only domestically, but also abroad and has caused damage by leading to rumours spreading. The Japanese government has already come out with the policy of enhancing the provision of information overseas, thereby increasing transparency.

The International Atomic Energy Agency has been supporting us. So, the issue of information disclosure has been improving very much.

Thank you very much for your kind attention.

S. Guriev:

Thank you very much, Mr Nishioka. Please accept our condolences on behalf of the panellists on this tragedy and also our praise for the courage the Japanese people showed in coping with the disaster. And I think this story is actually a great reminder that we should have some humility about our ability to predict risks. Because sometimes things like this happen and can completely destroy our projections.

With that, I will turn to the optimistic side. As I said, these things are not carved in stone. So some people are optimists on one side of the globe and pessimists on the other side.

But let me give the floor to Roland Nash, the Senior Partner in Verno Capital. Roland, please.

R. Nash:

Thank you, Sergei and thank you to Deutsche Bank and the Forum for inviting me to speak on this wonderful panel.

I think whether you are an optimist or a pessimist on what is happening in the world today really depends on where you sit, and not just on this panel, but more widely. And given that we are not sitting in Brussels, and we are sitting in sunny St. Petersburg, I find it difficult to be anything other than optimistic on the outlook of the global economy.

The latest predictions that had been put out by the IMF suggest that the outlook for the world economy has actually never been better. Let me put a few numbers around that.

Average economic growth per annum between 1950 and 2000 was roughly 3.5% per year. And then the world went through this growth spurt between 2003 and 2008, where growth went from 3.5% right up to 4.7%. It is one of the fastest five-year periods of economic growth in history. Then, obviously, we have the 2009 crisis; we all know what happened then.

But the outlook for economic growth right now, according to the latest numbers that have come out, and the first signs that these are actually the ones that are proving correct, the outlook for economic growth between 2010 and 2016, that entire seven-year period, is 4.6% per annum, on average. That is the same rate as we saw before the crisis, and again, one of the fastest periods of economic growth in history.

But there were two sort of main risks associated with those overall numbers. The first is the disparity in the growth, globally. And this is what I mean by where you sit.

So if you take the IMF numbers and you look at the top five fastest-growing countries in the world today over the next seven years, these are the countries: at fifth position is Mozambique, fourth is India, third is Ethiopia, second is China, and the fastest growing country in the world expected over the next seven years is Mongolia.

If you then look at the bottom five countries in the world, the slowest growing countries over the next seven years, those are Spain, Japan, Italy, Greece and Portugal. So it really depends where you are sitting, whether you are looking at the world as having very fast growth or slow growth.

So that is the first risk. The second risk I want to mention, then I will stop, is the potential of volatility because of the variance between the two blocs. So in many ways the biggest hope for the slow-growth economies is that the fast-growth economies are able to pull them out of growth to help cure some of the structural issues through global growth.

And the biggest risk, I think, to the fast growth economies is exactly what is happening in Europe and the US today, in addressing those structural issues.

I'll leave it there.

S. Guriev:

Thank you very much, Roland. Indeed, it is a true point we see that people sitting in fast-growing places or, just in nice-looking places like the Maldives which I discussed with Oleg here, probably have more a more optimistic view on things.

Let me turn to Elena Salgado who is the Vice-President of the Spanish Government and also Minister of Finance of Spain. Roland mentioned a couple of things. One is the growth issue, and other one is the fiscal issue. What is your take on what is happening in Europe and in global economy in general?

E. Salgado:

Well, the first thing that surprises me is that he says he is optimistic. And so, I think, this is something that we have to discuss later.

But thank you, Mr Moderator.

In the words of Keynes, "Facing uncertainty, men tend to assume—contrary to all likelihood—that the future will resemble the past." And so I think the crisis has shown that in general: risk perception, and I think the figures also said that. It is based more on convention and on rational assessment of economic fundamentals. So, the crisis is not only economic and political, but is also a crisis of our mindsets, and this is a big risk, because after the crisis, the new 'normal' will not resemble what we consider 'normal' in the past, and the transition will probably be a multi-year adjustment that would occur both on at the domestic and global level.

Well, at the European level, some of you may say we have some problems. Me, too. It is true that we are still facing challenging times, but we are taking bold steps towards integration and coordination of a common solution, which includes intensifying fiscal consolidation, along with enhancing structural reforms and finance stability through deep financial integration.

I am a politician, so I am going to talk about Spain because I think for what I sometimes hear, I think Spain is quite unknown, or at least, what we are achieving is quite unknown. The crisis has provided an opportunity to introduce improvements and reforms in Spain. It unveiled some structural weaknesses, imbalances hidden by a substantial period of strong growth. I have to say here that we were the European country whose growth was the fastest in the last decade. And as I said, some of these growths created big imbalances.

Today, we have to go through a deep process of structural rebalancing towards a more sustainable growth model, because I have to say that if you grow for several years at 4%, which in European terms is huge growth, but then when a crisis arises all around—and not any other country across the Atlantic, as this has been the case—and your growth goes down to minus 3 or to minus 4, then something is wrong. So it is not only a question of how big the growth is, but how sustainable the growth is; not only for seven years, not only for 10 years but over a longer period of time.

So we have gone, we are going through a process of implementing a very big structural rebalancing. The external deficit has been halved compared to 2008, so in only two years. Growth has stabilized this year and is expected to strengthen throughout 2011, 2012 and 2013. And the government is carrying out an ambitious programme, based on two pillars: fiscal consolidation and central reforms.

On fiscal consolidation, we have achieved an 11% deficit in 2009 and we want to reach a 3% deficit in 2013. So, a huge effort, and I must say that in 2010, we have delivered. We have met our deficit target for that year.

And public debt, over GDP, has increased up to 60% of GDP at the end of 2010, but 60% of GDP is more than 25 percentage points below the average of the Euro area.

And of course, we are also making big progress in the area of financial reform and the unprecedented restructuring process of the savings banks. We had 45. At the end of this year, we will have 16 or 17. A legal reform aimed at improving the governance of these savings banks and a recapitalization process is going to finish at the end of September, and all savings banks will have a capital ratio of 10%, except the ones which are listed.

Additionally, I have to say that we went through a very transparent stress test last year. 95% of our financial sector was involved in the stress test, compared to 50% for other countries. And these stress tests are going to be repeated this year, with even more stress scenarios and assumptions. We have adopted a far-reaching pension and labour market reform.

And so to sum up, and with respect to the outlook for the global economy and for Spain, I am optimistic regarding the new 'normal'. The transition will not be free of tension and the key challenge for policymakers will be to manage in parallel both the domestic and global agendas, thinking about what it is – an interconnected system.

So, to summarize, I am an optimist if, and only if, we remain activist.

Thank you.

S. Guriev:

Thank you very much, Minister Salgado. I applaud the Spanish policy response. But coming back to your first point about the EU, do you think the current crisis will create a system where more strict criteria will be actually met by all the members of the Euro Zone, somehow? Do you think it is going to happen in the foreseeable future?

E. Salgado:

Well, of course, I think probably next week, the council of heads of states and governments will approve a new form of governance for the European Union, especially for the countries in the Monetary Union, because we share a common currency. We do not have this possibility of devaluation and competitive devaluations that some other countries have. We do not have this possibility of quantitative easing, because it does not depend on any specific country. So we have to fight against the crisis with our own tools, and one of them is to prevent the crisis from occurring.

So apart from the financial side of the crisis, which is very important, part of the crisis, at least in Spain, has been produced by these macro-economic imbalances. So, not only are we going to prevent and to fight against the fiscal deficits or debt problems, we are also going to fight against these macro-economic imbalances, trying to prevent them.

So, we are ready to approve a new form of governance with sanctions, recommendations, European semester, planning on everything, programming, common exchange of all views of what is happening in any of the countries, to fight and to prevent the next crisis from occurring.

S. Guriev:

Thank you very much.
With that, let me turn to the other side and I would like Oleg Viyugin, Chairman of the Board of MDM Bank, to give his view on what is going to happen in the global economy, in the US economy, in emerging markets, and China. What is going to happen, Oleg?

O. Viyugin:
Thank you very much. Mind you, I didn't hear anything about how I am perceived. Am I a pessimist? Fine, since I am not a politician, I can afford to be a pessimist. I can try to prove that I am a pessimist, although perhaps that isn't the case.
The USA. If we take a quick look at the past couple decades—at the last 20 years or so—there has been no real wage growth in the US despite appreciable real consumption growth. Thanks to what? Thanks to dollars. Debt in effect has funded consumption growth and, in many respects, the growth of the economy. Moreover, the Wall Street economy has contributed to a certain amount of growth. I would like to pose a question to our esteemed audience: is anyone now going to continue funding household debt in order to perpetuate household consumption growth? Probably not. Only the FRS, the Federal Reserve System, might do that, but unfortunately, on a very limited scale. So, the challenge before the US at this point is to take a break from economic growth to figure things out because nobody is going to fund debt anymore.
Now, Europe, the European Union. The European Union is a rather healthy economic zone from a purely economic standpoint. Yes, there is the problem of debt there, too. It came about in much the same way. We've discovered that consumption can be funded by debt in the case of certain countries that are not economically competitive—this is what has transpired in various periphery countries. Now we have a situation in Europe, too, where nobody wants to fund

this debt. Essentially, the European Union has the opportunity to redistribute income internally.

It seems to me that the main challenge for the European Union at this point is to grasp the meaning of the euro. After all, the euro is not merely currency. It's far more than that. And serious decisions must be made that would transition the euro from the status of local currency to that of global currency because the European Union is a very small economic entity.

China. We have high hopes that China will boost global economic growth and facilitate increased prosperity. What is China's secret for economic growth? First, there is tremendous motivation for growth—from the ordinary Chinese citizen to the corporation. It's obvious. All you have to do is visit China to see how people work and what is going on there. Second, there is a significant influx of capital into the country rooted in investors' awareness of this motivation. That is very attractive in terms of investments.

And the third factor is protectionism. What is going on today? As a result of global events, protectionism has begun to give rise to significant distortion effects. Obviously, China's regulatory authorities are under considerable pressure to loosen protective measures. By the way, the Chinese President addressed this today in his speech at the plenary session.

This means that in order for the capacities created by investors in China to be utilized and to continue to produce surplus value, we have to stimulate domestic consumer demand and domestic households. This should make Chinese citizens wealthier. By the way, the Chinese President spoke about that today, too. He said that moderate prosperity is his goal. But if Chinese citizens become wealthier, then their labour will become more expensive. If their labour becomes more expensive, then investors won't have such a wide investment margin in China. This is no drama. It means that step by step the growth rate of the Chinese economy will be reduced to a reasonable level. Thus, the current challenge for China can be understood in terms of 'less is more'. That's the well-known phrase denoting national policy at the turn of the 18th century. In other words, the current economy must be geared towards good growth based largely on domestic consumption. And this implies slower growth.

All of this suggests that the global economy is due for a serious cooling period. What risks does this entail and how should we view it—as a pessimistic or an optimistic development? It all depends on where you sit. Actually, slower growth is indicated by the existing stratification, first and foremost, among the world's disadvantaged population. This, in fact, is the main risk because people might not want to put up with a situation like that. I consider it the principle risk—even with careful and correct management—which isn't easy since government and central bank decision making is largely intuitive rather than based on economic theory. Although economic theory is foundational, any mistakes made in this arena have potentially serious consequences and risks.

It's very easy to generate a crisis a few years down the road—all we have to do is make a few major management mistakes today. In this sense, I am a pessimist because I understand that such mistakes are possible. History demonstrates that they have been made. But I am an optimist from the point of view that even without such mistakes, we may not have the happiest period in global economics to look forward to over the next five to ten years. But that doesn't mean the end of the world is coming.

S. Guriev:

Thank you. I think you have justified your title of pessimist, but I have a question. Maybe everything will get a little worse. You presented the scenario of a growth slowdown in China, which, actually, is good and natural. But isn't it likely that this slow-down will not be gradual, that it won't be a 'soft landing'—rather that we already have a bubble and this bubble will burst at some point? Or is this the mistake you spoke of?

O. Viyugin:

In my opinion, the mistake has already been made—overestimation of the value of Chinese real estate. Stock market assets may likewise be overvalued. That is already evident. But judging by what the authorities in China are doing now, this is my assessment: first, they understand, and second, their actions are guarded, and there is still a chance they will avoid a drastic change in the situation.

S. Guriev:

Thank you. Compared to this stance, anybody would be an optimist. Let's hear now from Yaroslav Lisovolik, Chief Economist and Member of the Management Board of Deutsche Bank Russia.

Y. Lisovolik:

Well, I think clearly the job of the pessimist today is a very easy one, given the events of the past several months. And clearly, in general, the job of the pessimist is inherently quite an advantageous one because pessimists are either right or they have a positive surprise for themselves. And in that regard, I think what I will try to do is... well, clearly it is going to be a challenge, again, given the recent developments in the economy, but I will try to present to you some of the views that I have, that I think do provide some grounds for optimism in today's world economy.

Well, first of all, I would refer to the first wave of the crisis and the fact that it was not as severe and profound as a lot of the economists predicted. You all remember fully well all of the forecasts from one to two years ago, how economists illustrated their views on the evolution of the world economy through different letters.

And one of the more popular letters at the time, you might remember, was the letter L. There was the letter W. But in the end, things turned out to be somewhat more boring, I guess. Things were resolved relatively quickly.

And the second wave of the crisis that markets have been talking about for so long, for almost two years now, it has not really transpired, and I think one of the reasons may be that, just like this is the first truly global crisis that afflicts the world economy, so is the response on the part of the world community a truly global one, a coordinated one.

And just as globalization may lead to negative spillover effects during the crisis, so it is the case that anti-crisis measures in some of the large countries may spill over in a positive way, through positive spillovers to other countries. And this is essentially what happened, I think.

So essentially, I think the outlook for the global economy, as Roland has already pointed out, you will look across the broad spectrum of forecasts, it seems to be relatively favourable, and still the fact of the matter is that no second wave of the crisis has taken place. We project the global economy to grow this year by 4% and then 4.4% in the course of next year.

Another group of risks that I would point out is something that Mr Viyugin has touched upon: the risk of protectionism, capital controls and devaluation wars. And that is a risk, again, I think that has not been nearly as pronounced compared to the concerns that we have heard in the past one to two years.

Certainly, there were flare-ups. Certainly, we have seen some of the countries introduce capital controls. There were some signs of competitive devaluation, but overall still it does not seem that it was as pronounced. And perhaps one of the reasons, again, was that the recovery of the economy was more emphatic after the first wave of the crisis, it was relatively quick.

And then the final point that I would make is, if you look at the three main centres of the global economy—Europe, the US, and China—yes, there are risks. Virtually everywhere you see risks. But at the same time, you see some positives as well.

So, if you take Europe, clearly the issue there is with the Greek debt and the Greek fiscal policy. But, on the other hand, look at Germany. And Germany is growing by more than 3%. We are projecting economic growth there to be 3.3%. And perhaps, again along the lines of what Roland talked about, some of the larger economies may pull the broader region out of its misery, out of the crisis.

And then if you take the situation in Asia, yes, certainly there are some risks associated with the bubbles building up in the real estate segment and other segments of the economy, but we clearly saw that the Chinese authorities were proactive in trying to deal with some of these problems, through monetary policy means. And I think overall the balance of risks there is not that pronounced.

The final point that I would make is that virtually every region of the world economy has gone through a crisis, from which it can learn going forward. And there are signs that countries do learn. And one of the best examples for me in that regard is Russia itself.

If you compare Russia's performance in 1998 and the year 2008, during those two crises, clearly there was a very significant difference, and the corrective action that was taken with regard to fiscal policy, the build-up of reserves, and the pre-payment of debt, all of that provided the groundwork for Russia to weather this very significant storm.

So that is probably the main hope that I would express here, that countries hopefully do learn.

S. Guriev:

Thank you, Yaroslav. Let me challenge you, as a devil's advocate, or a pessimist's advocate. You mentioned the effect of anti-crisis measures in a globalized world spilling over to other countries. But we saw that such large fiscal deficits are not sustainable. So some of these measures will have to be rolled back, and some are being rolled back as we speak. Spain has consolidated fiscally. Other European economies will cut their expenditure. The US will have to undergo serious fiscal consolidation. Would that not result in a slowdown? What do you think?

Y. Lisovolik:

Well, of course the withdrawal of fiscal stimulus is something that is going to be a drag on the countries that were especially prominent in using fiscal policy to speed up their economic development.

But at the same time, mind you, some of this fiscal stimulus that took place, just as I said, it relieved some of the other economies from undertaking as massive a stimulus and, accordingly, for some of the other economies in the world, the challenge of the withdrawal of stimulus might not be as significant.

After all, I would argue that there were a lot of countries that actually have the pleasure to free-ride on the economic stimulus in some of the large countries.

But in the end, I think it is also a healthy thing that this withdrawal of fiscal stimulus will guide a lot of these countries towards a more sustainable trajectory and they will be more guided by rules, rather than discretion. And that is the hope that I see going forward, that the future world economy that will emerge after this crisis will be an economy that operates on rules, rather than discretion.

S. Guriev:

Thank you very much, Yaroslav.

Let me return back to the pessimist side and ask Brian Leach, who is Chief Risk Officer at Citigroup, to provide his views. By definition, you have to be a cautious pessimist, at least.

B. Leach:

That is no doubt that as a Chief Risk Officer, I am not allowed to sit on that side of the table.

I think that as many have mentioned, the base case is that the world is doing pretty well. We have good growth. We have luckily a lot of growth coming from the developing world, and the developed world is struggling. The flood of liquidity has helped. The somewhat high commodity prices, you might argue, have helped. They are not too high, not too low. They are able to help some of those countries do very well.

But, in my position, I am always worrying about what might happen, and so I do spend more time on the dark side.

And as I look through them, the concerns that I have is that the Middle East, North Africa, MENA are significant risks. We have seen obviously a number of regime changes. We do not know exactly where it will stop, but we certainly can think of a fat tail where it would stop, which would be quite a struggle for the world. And I am not just looking at oil prices at that point. We are looking at significant consequences.

The overleveraged sovereigns around the world are also an issue. Most of those are the developed world. They are not the developing world. In the developed world, it is the secondary-order consequences of most of these. I think most of these risks we all know, but it is the question, 'What happens next?'

So in the United States, is the debt ceiling going to be an issue or is the budget deficit going to be an issue? They are a mirror image. The secondary-order consequence is what policies will be adjusted in the United States because of those difficulties? So you could imagine policies being changed such that the housing market could be impacted, or that entitlements might be hit.

Europe. I think we all understand Greece. The question is, 'Does it go beyond Greece?' So again, secondary-order consequence of those.

There is certainly a lot of regulatory uncertainty around the globe. In the financial world, there clearly are many places, but there are also questions as to whether regulations will look for more regional or country-specific boundaries to put in place.

There are questions of emerging markets' bubbles, and I think we have obviously seen a lot of liquidity monetary stimulus flowing into Brazil and others. So we have a bit of a question of a bubble there.

We have some inflation, with some potential for rising rates. And then we have got a couple of geopolitical hot spots. So I think North and South Korea continue to be an area that concerns me. And the recent elections in Peru, we have to see how they will play out.

So that would be the list of things that I would look. And again, I believe that all of us know what that list looks like, but I think if we think about the secondary-order consequence of that list, those are the parts that are concerning me the most.

And I will leave it there.

S. Guriev:

Thank you, Brian. Are there any risks that can create an upside? A sudden productivity miracle in some part of the world?

B. Leach:

There are a couple of things. The tragedy in Japan is going to require reconstruction. That is going to be an issue. You could imagine that a positive debt ceiling resolution in the United States, which could be literally imminent, could again create a very positive outcome. And if the world were to look at the European situation and be able to put a firewall between Greece and the others, again, that would be a very positive event.

So I think there are a series of things that can create an environment that will be really positive. I think there are a couple of things that are hard to foresee, the political dynamics in the Middle East being resolved easily. You might have some more regime changes, but it is not clear to me that that stops the item.

S. Guriev:

Thank you.

With that, let me turn to Aleh Tsyvinski, who is a professor of Economics at Yale University and a Co-director of the Macroeconomic Research Program at Cowles Foundation. Aleh, please.

A. Tsyvinski:

Thank you, Sergei. Thank you to the organizers of the forum for this interesting panel.

What I will try to talk about is what I think is going to be the key trend of the next decade, or at least for the next five years. And I think what is going to happen is that we will see the convergence, in terms of the growth performance between Europe and the US. Europe is going to look more like the US looked before the crisis, and the US is going to slow down.

So, you can ask, "Well, how can this happen?" Europe now is on the verge of one of the largest crises, perhaps to some pessimists, I think, and maybe the Euro and Europe as a project will fall.

Well, let us look at what the experiences are of the large fiscal consolidations. If you look at more than a hundred such experiences, in terms of the year, starting from 1980, actually a large amount of the periods of huge fiscal consolidations were expansionary.

And again, how can this happen if you have a Keynesian view of cuts in spending or believing that withdrawing fiscal stimulus should lead to lower growth? Well, the devil is in the details: the periods of the expansionary fiscal consolidations were the ones coming from the spending cuts, as opposed to the increase in taxes.

What is happening in Europe now is that because of the crisis and because the financial markets are forcing the hands of the governments to implement the structural reforms that were for so long needed in many of these countries—Spain, Greece, and Portugal—what we are seeing in Europe is an unprecedented period which will lay the foundations of the faster economic growth in Europe.

Or one can ask the question, "But is this politically sustainable, the periods of fiscal austerity?" They must lead to the politicians who have implemented this to be voted out of power. Again, if we turn to the empirical evidence, there is no empirical evidence that the periods of fiscal austerity lead to loss at the polls, on average. Again, there are cases for and there are cases against, but there is no statistical significant evidence of this.

In fact, there is slight statistical evidence that in the countries which implement the periods of fiscal consolidation, the politicians would win slightly at the polls.

Well, what would this lead to? As I said, the structural reformatting being implemented, especially in the peripheral countries of Europe, is going to lay the foundations of faster economic growth.

Well, now let us look at the US. In the US, on one hand, there are issues with the debt. The debt seems to be unsustainable. But there is no acute crisis that would force the hand of the US government and the US policymakers to implement the wide-reaching reforms that would lead to the decrease of the debt. That is why, I think, this is going to lead to a significant… or at least a slowdown of US economic growth.

Let us look at another dimension of this issue: what is a politically attractive way to cut that in the US? Who holds the US debt? Well, it is the old and rich households and foreigners. And who is indebted in the US? It is the middle class, and it is the relatively young middle class.

If you count the numbers, if you inflate, you would be helping out those who have mortgages on their houses. And, if you compare this to fiscal austerity, inflation suddenly becomes an attractive option. This is another danger, another risk of inflation, that may be connected to slow economic growth.

Well, the question is, "Why are the yields on the US debt so low?" And I think the answer to this is what we have seen in the world economy after this crisis is the dramatic decline in the supply of the safe assets.

Think about 2007. We had all kinds of wonderful triple-A mortgage securities. What is there now, in terms of safe assets? Well, the US is still able to produce a supremely competitive product, which is reasonably good and a time-tested economic policy, that allows to issue long-term instruments which the rest of the world has difficulties replicating.

Another issue I want to touch upon is to talk a little bit about Japan. As Nishioka-san talked about the disaster in Japan, I think what the earthquake and tsunami showed is how important Japan is for the world economy. We tend to forget about Japan because of the 'Lost Decade' of growth.

Now the question is whether this huge disaster would force the hands of the politicians in Japan to get over the decade of the lost growth and grow faster. And if they get faster growth in Japan, it would be another positive upside for the world economy.

So just to summarize my position, I am a two-handed economist. I say on the one hand we will see an increase in economic growth in the Euro area. On the other hand, we will see a slowdown of economic growth in the US, and I think that is what is going to shape the world economy for the years to come.

S. Guriev:

Thank you, Aleh.

I would like to reiterate Roland's point that it depends where you sit. If you sit in the US dollar, inflation is good, but if you sit in Russian roubles, inflation is not that good.

But coming back to your point about the supply of safe assets and the low yield on US debt, you are talking about nominal. But I think the big puzzle is why the

difference between yields or nominal bonds and inflation-protected bonds is so low.
The markets simply imply something like 2% a year for the next 10 years, in terms of dollar inflation. Why is that the case?

A. Tsyvinski:
I think the market is under-pricing the possibility of US inflation. And I think the reason, as I said, is a political, economic reason. Inflation in the US is just becoming too attractive a political option, especially because of the decrease in the supply of safe assets that foreigners, despite the higher inflation, will have to buy US debt.
So the global imbalances about which so much is talked about are, in fact, global balances. You have to think about the US debt as a supreme export of the country, which is difficult to replicate in the rest of the world.

S. Guriev:
Great. So people who want an investment idea, Aleh is selling you an investment idea: invest in US inflation.

S. Guriev:
Thank you very much. I would like to give Alexei Kudrin the opportunity to speak. Whenever he speaks in Parliament, he is generally a pessimist. But I imagine there are no United Russia members present, so you can allow yourself to be a centrist. Please.

A. Kudrin:
Thank you. I was just considering whether I am a pessimist or an optimist and I realized that I am like the financial markets. When something good happens, they become optimistic, rates grow. If something bad happens, that optimism

goes by the wayside. I operate the same way in the government: whenever we manage to make a good decision, I'm an optimist—and vice versa.

Today, the leading share indices in many countries have reached a pre-crisis level and I don't think they are as reliable as the fundamental indicators. That's why it's time we become a bit pessimistic since the risks we have been talking about all day can create an entirely new situation. And today I assume more the role of a pessimist because I think that the potential risk for a significant decline in economic growth might be somewhere in the realm of 25%. Maybe not to the point of recession, but it will be a significant slowdown even in the intermediate period—in the next two to three years. The existing operating models of central banks and governments will have to be revised on account of deficits. Bad assets will force a change in the situation.

I would be inclined to agree with my colleague. Mr Viyugin, who named America, Europe and China as risks. To this I would add that American citizens have to come to grips with deficit reduction and, essentially, reduction of consumption—for that matter, with a replacement of the pre-crisis model that, at least in part, was the cause of the imbalances, and even gave rise to it when consumption continued to grow at a time of significant borrowing and low savings in the US. Will this model be replaced in the US? At this point, it is artificially supported.

We say that there is no risk of a second wave. Have we already gone through it, or does it lie ahead of us? To some degree, we have managed to ward it off using artificial means of support. I hope that we can soften the impact or prevent the possibility of a second crisis. But we have yet to see the second wave. We talked about that today. Budget models will be restructured. Imagine, today we need to cut budgetary expenses in leading countries by as much as 15-20%. That means that social support models will have to be revised significantly. We will need to streamline priorities and reconsider the role of the government with respect to budgetary support of individual sectors. Presumably, we will have new social regulation models that are geared more to citizens' funds, that is to say private payments, and this model, too, must be balanced, accessible to the public and insured in some way. But total funding for social services will increase dramatically. I think that is what lies ahead. The transition will probably take several years, but it would appear that we are now ready to take serious steps in this direction.

This crisis was indeed a global economic crisis. And we say that global imbalances are not yet completely liquidated. It’s possible that in some places imbalances have become more pronounced. We have to realize that we are up against the collision of a global economy, global flows of capital and goods, and national regulatory systems. And now we are faced with the need to come up with a supranational regulatory system. Strengthening the G20 is one way to approach the situation. The establishment of the Stabilization Fund in the European Union, a huge stabilization fund for the entire eurozone, is yet another. With all of this, it has become necessary to require that all eurozone participants adhere strictly to fundamental indicators. Germany’s work force is unwilling to come to terms with the fact that some of Greece’s social or labour standards are significantly more lax in terms of workday length, holiday leave and other parameters. As it turns out, the Greeks worked less and now we need to bail them out. The unification of certain positions affecting movement of capital, budgets, the labour market, and commodities markets should be more aggressively pursued so as not to allow further imbalance.

We look to Europe as the model which, to some extent, should eventually operate on a more global scale. We would like to see the European model, the eurozone model demonstrate success. That’s why we see the upcoming agenda in terms of two phases. Eventually, everyone will realize that Greece and Ireland and other countries must have more strict economic indicators that are enforceable by certain European Union agencies. But what do we do in the interim? How do we get beyond this point? Do we forgive? Do we pay? “Pay for our sins”? Then other countries will have to pay, too.

That's a very serious issue. Europe is facing it. We are all facing it. I think that the whole world is interested in solving this problem—not only for the short term, but also for the long term. That's why I believe we need to increase the European Union Stabilization Fund. I think the IMF needs to take a more serious approach to the situation. The next IMF Director—and we'll know who that is at the end of June—will need to be more aggressive, more rigorous in terms of fulfilling the mission of this global institution, which is to monitor macroeconomic parameters and imbalances, and have more resources. Then we will be able to talk about increasing IMF capital and, presumably, countries like China and other developing countries will take a more active part—including with their resources. They will pay to have a voice in these institutions, and we will have a legitimacy shift, that is to say a broadening of participation to include other countries, but on the other hand, a consolidated unit working on global imbalance.

Russia must be fully engaged in the process. We are already engaged. We are participating to the tune of approximately USD 15 billion both in new agreements and IMF loans, the IMF having established a USD 600 billion aid fund. And in this way, through the IMF fund, we are indirectly supporting the European Union. We are willing to participate in the purchase of obligations that are guaranteed by the European Union. We are ready to broaden and participate in special borrowing mechanisms set up by the European Union. So we are all becoming more closely knit around this effort to reduce risks and create reserve funds. I think this move toward creating global institutions is a significant step toward reducing global risks.

Last. We had a long discussion at the G20 with my colleague, the Minister from Spain. We discussed what we are willing to do in the initial phase. And during this initial phase, we managed to agree that the US and China are willing to undergo independent monitoring and accept recommendations. We haven't yet come to the point where we are discussing sanctions for significant deviations from acceptable macroeconomic parameters. We are all at the mercy of the

Federal Reserve System, the US deficit. That is why we absolutely must take this step. Thank you.

S. Guriev:

Thank you very much. I have a quick question for you. You are known as a liberal, and in this sense don't you think that the pending government spending cuts which you mentioned and which, perhaps, will become effective for the entire world in the long term, as Oleg said, will promote economic growth?

A. Kudrin:

Obviously, we have to curb our governments' appetites for spending and contribute more to the simple private sector, to private investments. I think this is a significant factor for growth.

S. Guriev:

Thank you very much. Vladimir Mau, Rector of the Russian Presidential Academy of National Economy and Public Administration, has joined us. He was at a briefing about privatization. Vladimir, I have a few brief questions for you in response to which I would like to receive very brief answers. What is going to happen to the American economy, the European economy, the Asian economies, and are there any other problems? And what do you foresee in terms of the global economy?

V. Mau:

You know, two outstanding economists have offered two opposing views in response to approximately the same question. John Maynard Keynes said that in the long run we are all dead—and that was the pessimistic point of view. But Joan Robinson replied, "It's you, Maynard, who is dead. That doesn't affect the rest of us." And from this point of view, the question of pessimism and optimism, about what is going to happen to these economies, depends on historical distance and criteria of success. Obviously, all of these economies will survive. And that is good news. It goes without saying that economic revolutions and budget overhauls don't happen overnight. If the hypothesis that this crisis can be set alongside the crises of the 30s and 70s is correct, that is to say that it wasn't so much cyclical as structural, then the experience of the previous two crises suggests that this crisis, too, must address questions related to the emergence of a new regulatory system.

If you remember, during the early months of the crisis—after Lehman Brothers—we all became Keynesian in the vulgar sense of the word: we said that we would regulate everything now. But soon thereafter the leaders of most countries came to their senses and recognized that we were more likely dealing with a new model for regulating financial markets, with the transformation of financial markets, with the notion of bringing financial markets together: goods, currency and fund markets. The search for a global regulatory model as opposed to regulatory economics or a return to a traditional regulatory system. Certainly we must find a solution for a relatively new currency system model. The role of the yuan, the role of regional reserve currencies—that's an obvious question.

Again, the crises of the 30s and 70s presented new questions and answers relevant to the world's currency situations. This is the answer to the question about new geo-economic balances. Fine. Keep the US in check since we all use the dollar as reserve currency. But I want to remind you of the classic answer offered by the American Secretary of the Treasury in the 70s—"The dollar is our currency and our problem." In the final analysis, if you use the dollar, why should we have to keep it in check? With similar success we can offer to keep Chinese demand in check since that, too, is important for prosperity in the rest of the world's countries. I don't think the world will go that route or that this will happen.

Generally, I think that for the short term we can be cautiously pessimistic since the crisis has raised questions without yet providing answers. Growth recovery and overcoming recession—this is not synonymous with the end of the crisis. In the same way, it seemed that the crisis and the Great Depression were coming to an end in 1935, and then it became clear that this was just a phase. We have questions without answers. There is a moral hazard, there are problems rooted in a resistance to restructuring.

Worse yet, I will dare to tread into the inner sanctum. I have always been and remain an active proponent of the Stabilization Fund as it applies to Russia. I view it as an important mechanism for solving the problems of windfall money. But at the same time, the experience of the past two to three years has demonstrated that the Stabilization Fund is also a significant institutional obstacle on the path to modernization, the path to structural transformation in the sense that if you have money, you can buy stability, you can afford to continue pursuing reforms even in crisis conditions. Where do we find the solution? On the one hand, it's impossible to forgo the Stabilization Fund because funnelling 'hot money' into the economy is dangerous, it's pointless. But on the other hand, how do you bring about structural transformation with the Stabilization Fund in place—if oil prices don't drop, that is, of course? That, too, is a very serious, though separate challenge for our economy. In my view, it's one of the most serious challenges we face.

S. Guriev:

Thank you very much. Our time is almost up, but we have a few questions for voting.

I would like you to pick up the voting devices, so let us put up the questions on the screen now. And basically there will be two questions: one will be on the source of the problems, and the other one will be on the sign and magnitude of the problems.

The first question is on the source of the problems. If you think that there is a crisis or slowdown in the global economy in the coming years, do you think it will come from the US, from Europe, from China, from other emerging markets, from other sources, or will there be no slowdown or crisis?

So if you are an optimist, you will have to press '5'. To vote, please first turn the device on with the green button and then you can vote now within 23 seconds. You have twenty-one seconds now to decide who you are. So press the green button first and then press 1, 2, 3, 4, or 5.

Okay. The vote is done and we see that the problems in the US Markets are not so sure, but at least this audience believes that the US is the source of the problems. But let me now ask you another question. Whether you are an optimist or pessimist, of course it depends on the definition. And for Russia, this definition is very simple.

As Vladimir said, everything depends on oil prices. Oil prices depend on the global economy. So let us put out this as the second question, 'What do you think is going to happen to the oil price in the coming years?' Will it substantially increase, decrease, or roughly stay the same? Please put up the second question.

If again, I could ask you to turn the device on by the green button and then if you think that the oil price will increase, that means you are a global optimist or geopolitical pessimist if you think something geopolitically bad may happen in oil-rich countries. '2' means you are neutral, and '3' means you are a pessimist on global economic growth, or an optimist on technological development in this industry. So 1, 2, or 3. Please start voting.

Yes, now you can vote. Turn the green button to turn the device on and then vote.

So we have time for one more short question. We are running out of time, so if you do not have a question, let us give it. But do you have one short question?

No, okay. So let us wait for the result of the vote.

Okay, so I don't know what to say. I would say that it means pessimists are slightly outnumbering optimists in this audience. But I would say that the level of

uncertainty is certainly high. And with that, let me close this session, I would like to have a big round of applause for the participants. I think we have learned a lot from this, at least I did.
Thank you. Thank you very much.