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Securing the Future

THE ROAD AHEAD FOR THE GLOBAL ECONOMY IN TRANSFORMATION

Panel Discussion

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Moderator:

James Harding, Editor-in-Chief, The Times

Panelists:

Mark Haefele, Head of Investment, Wealth Management, UBS

Mulyani Indrawati, Managing Director, The World Bank

Alexei Kudrin, Dean, Faculty of Liberal Arts and Sciences, St. Petersburg State University

David Lipton, First Deputy Managing Director, International Monetary Fund

Lord Mandelson, Chairman, Global Counsel LLP; European Commissioner for Trade (2004—2008)

Tharman Shanmugaratnam, Deputy Prime Minister, Minister for Finance and Minister for Manpower in Singapore

Hu Shuli, Editor-in-Chief, Caixin Media

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

J. Harding:

Ladies and gentlemen, good morning and welcome to this session on The Road Ahead. My name is James Harding. I am the editor of The Times. As you can see, we have a huge subject ahead of us and I hope that we have also a very insightful and informative conversation. We have a terrifically impressive panel of people. I do not know what the collective noun is for finance ministers, policy makers, and financial thinkers. I would say it is probably a treasure trove. We have that for you today. What we are going to try to do, given the number of people on the panel and the scale of the subject in front of us, is I am going to ask each person just to speak for a few minutes about what they think are the key factors on that road ahead, what are the really important obstacles and what are the ways around them. Then we will dive into some of those subjects in a conversation, and I hope then to open things up to you for some questions. We will try and keep tight to time. Let me start with Tharman Shanmugaratnam, who is the Deputy Prime Minister of Singapore, the Finance Minister, and of course the Chairman of the IMF Committee. I would be very interested to hear your views, Tharman.

T. Shanmugaratnam:

I think the first challenge is simply getting back to some sense of normal growth within the next two to three years. Very few people believe that we are going to get back to normal growth, in the United States, and in Europe especially. Very few people believe that. The credibility of public policy actions is now extremely low. Part of the problem is that the solutions so far have been short-term, demand-oriented, and rather defensive. They have been very defensive measures and people have lost confidence in this. If you do not get back to normal growth within the next two to three years, you are not going to get to the situation in eight to ten years when structural reforms, austerity, and all the underlying reforms will truly come to fruit. Things can go badly wrong in the next two to three years and you will never get there. What has to be done, really, is to restore the confidence of private investors and they bring with them job creation. What we are seeing now is exactly the opposite. We are seeing, in Europe especially, the disengagement of private investors. Every opportunity, every time official support steps in, private investors take the chance to run. This is exactly what is happening. And we have to bear in mind that in the next two to three years the amount of private money required to merely roll over debts or banks and sovereigns is very large. We are not just talking about recapitalizing Spanish banks, whether this requires EUR 62 billion or over EUR 100 billion. We are talking about trillions of euros being required to roll over sovereign and banking debts. So, you need private money, official money cannot do it. You have to bring back confidence. And the way to do it, essentially, is to focus more on bringing long-term projects into the short term, bringing supply side reforms into the short term, investing not just for immediate stimulus or immediate consumption, but investing in productive capacity now, investing in the skills of the unemployed and the skills of a new generation, so that you provide some hope for the future but you also put people back to work now.

J. Harding:

Thank you very much indeed. I am sure we will come back to that, and particularly to the question about private sector investment. To my left is a gentleman who, I know, needs no introduction in this room, one of the pivotal figures not just in Russia's modern history, but in the world economy in the last decade.

A. Kudrin:

Good afternoon, thank you.

I do think that debt is our problem in the short term, and today we find ourselves in the middle of a minefield. As far as finding a course of action in this situation is concerned, it is clear that the minefield must be swept. We must now transition from preparation and strategy to a concrete course of action. How can the sovereign debt problem in Italy and Spain be mitigated? Solutions will include everything from debt restructuring to partial write-off of debt to additional external recapitalization for banks that will suffer losses and be unable to maintain their capital.

However, we also have problems in the longer term. One of the most basic problems has been the fact that during the period of prosperity of the past 15–20 years, the leading nations and the whole developed world have been accumulating debt. During a period of prosperity, the developed world should have done as much as possible to reduce debt instead of adding to it. Having entered a period of downturn, we must now compensate for problems in the market, including using credit and mitigating sovereign debt. However, we have reached a frontier which neither we nor the developed nations will be able to sustain. This means that we have had a fundamentally flawed concept of public policy, including expenses. We have built social welfare states and spent freely without having any real grounds for doing so. We lived on credit and must now pay it back. We must seriously rethink our conceptions of the state and the makeup of the public sector. This type of reform will be necessary for all nations during the next 10–15 years. Each state will need to develop a new model for the development of social programmes. And there is another unresolved contradiction. The low levels of savings and high consumption rates in developed countries create a corresponding imbalance in the global economy. These imbalances have come no closer to resolution as the crisis has developed over the past two or three years. As a result, one of the factors contributing to a prolonged crisis has been left unchecked. That is why I do not see normal, stable growth returning within the next two or three years. We will be walking through a minefield. The question should be posed in the following way: will we find within the next two or three years a solution that could mitigate the problem?

J. Harding:

Thank you. Mr. Kudrin, I hope we can come back to that question about the level of state spending and the quality of growth in Russia. Maybe we will do that as we get back into the conversation. Can I turn now to David Lipton, of the IMF, who is way over there in Vladivostok? Mr. Lipton, how do you see from a very macro level, the outlook for the world economy?

D. Lipton:

Thank you, James. It is a pleasure to be here at the Forum. I think it is best to start a discussion of the road ahead by answering the question, what is the biggest problem we have to face? And I think the problem right now in advanced economies, broadly speaking, is that there is a huge process of deleveraging going on concerning sovereigns, households, and banks simultaneously. That raises the question of if everyone is deleveraging at the same time, where is growth going to come from? And if there is no growth, how will deleveraging ever be successful? That question has to be answered. Obviously, Europe is the epicentre of the problem, so let me say a few words about the European situation. There are in essence two problems in Europe, first that the markets are under a very great stress right now increasingly because the markets are beginning to question the viability of the European Monetary Union itself. I think it is very important that eurozone countries address the long-run question: where is the architecture of the European Monetary Union going? How will they complete the Union? They started with a single market, but there are 17 banking sectors and regulators, 17 fiscal authorities. I think they need in the first instance to work on financial integration, to reduce the risks of the individual country problems, and break the link where if the banks have problems and the governments bail out the banks, then the governments have bigger problems that come into question. They have to move on to the question of how a fiscal union will eventually take place and settle, once and for all, the question of the architecture. Will it be a hybrid, or will it be increasingly a true union? Of course, in order to do that in the long run they have to survive in the short run. This means creating a situation where there is enough growth that countries can handle their particular problems. They have to pursue fiscal consolidation where they have deficits and debts that are very high, they have to permit deleveraging in some cases in households, in some cases in banks, and both in other cases. To pursue growth they are going to need to first make sure that their policies do not make the growth situation even worse. There must not be, broadly speaking, deleveraging across the banking system that causes a credit crunch and undermines growth.

They need to use all the policy levers they have to support demand. They need to pursue structural policies to raise potential growth over time, but pick and choose carefully among those the structural measures that will be growth-supportive in the short run. That is a very general overview of Europe, and there is plenty more to talk about how you would actually do that. But, it is very important that Europe settles those problems, because the rest of the world depends so much on Europe. The United States has its own issues. It is growing, but it has to settle its budget problems, not fall off the fiscal cliff, and keep growth going. Emerging market countries are being affected by what is happening in the advanced economies, by the slowdown, and I think their long-run prospects are very much in question if advanced economies stagnate for a long period of time. Emerging market economies have to, in essence, prepare for a period of difficult economic times where the stagnation of advanced economies may have ramifications for them. They have to work as much as possible to continue the important convergence process that has been under way.

J. Harding:

David, thank you very much. I hope we can get back into that, particularly that theme of how to do things that are good for the long term, without imperilling them in the short term, and vice versa. I am going to turn now to Hu Shuli who runs Caixin Media. I can say this as one journalist to another: Caixin Media is probably the most interesting journalistic organization at work in China, particularly on business news and the economy. So I will turn to you, Hu Shuli, to talk about how you see things panning out, particularly with a view to China.

H. Shuli:

Thank you, James. We are here to talk about restoring global confidence. I think it is important to remember that there is no one-size-fits-all solution and what meets European needs does not necessarily apply to ASEAN. What China is looking for is not what the United States is yearning for. I just want to give you my wish list about

China now. I think there are three sectors. It is simple: liberalization, levelling the playfield, and a road map. There are a number of things that need to be freed up. Mostly, I think, interest rates and pricing of key resources, just to name a few. Moreover, China should give the private sector equal treatment, especially when it comes to access to finance and investment opportunities. The rule of law is a long story, but to shorten it I would say it is a single fundamental sector that can lead a country on a healthy path, especially for a transitional country. That is, therefore, very important for China. If we consider what we have learned from the European crisis, one of the major lessons that I think China should take from it is that you cannot live on borrowed time and refuse to resolve the most difficult, but also crucial problems. China showed that that stuff is essential for political reform. That is very important. Thank you.

J. Harding:

Thank you, Hu Shuli. I think we will come back to all of those issues, with a view to both China and Russia, shortly. I know we are doing a dance around the world. I am going to turn back now to Europe and the Western economies and ask Lord Peter Mandelson, a man who shook British politics for much of the last decade or two, served as a European Trade Commissioner and now runs the Global Council, to give your view on where we stand in Europe. Peter.

P. Mandelson:

Thank you very much everyone for being here. My view, James, is that the problems that we are experiencing in the global economy have their roots in the sort of fool's paradise that we were all living in and enjoying when the entire global economy was awash with credit and when, as a result of that, just about everyone – individuals, households, corporate entities, certainly sovereigns – borrowed and spent beyond their means. That is what is now catching up with us, and it is catching up with us with a particularly acute set of conditions in Europe, where we have the intertwining of sovereign debt crises and banking crises, which makes any sort of resolution very difficult to resolve quickly and in a synchronized manner. The heart of Europe’s problems in my view, and the Achilles’ heel of Europe’s condition, is the state of our banking sector. Our banks, just to generalize, were responsible for extreme levels of careless lending. There was excessive borrowing, there was poor corporate governance, there was very risky trading, and all these have created weaknesses and vulnerability in our banks. Most of the problems around these have found their way, in one way or another, onto sovereign balance sheets, and amongst those eurozone sovereigns that were already pretty vulnerable and shaky in their national finances, they have found these conditions very hard to cope with for reasons I think we all understand. Of course, the eurozone itself is in my view a sound project, a good currency. Nonetheless within this framework, the eurozone found itself particularly vulnerable to problems of sovereign debt, for which it does not have the institutions, the functioning central bank, and the collective sharing of responsibilities and of financing of sovereigns and banks when they get into such trouble. We now realize it was not so much a failed project, as an incomplete project. How we both fire fight – deal with the banking and sovereign debt crises – how we put out these fires and deal with the emergencies that we are in, and at the same time, undertake some much needed but very complicated running repairs and an overhaul of the eurozone, from which I think that a eurozone mark two can and should emerge, but it is not certain or inevitable that it will. That is the very complex set of political tasks facing European leaders now at a time when they do not frankly agree either on the timeliness or extent of the fire fighting, nor on the required necessary running repairs to the eurozone. It not merely a question of disagreement between governments – we have a state of public opinion which is deeply anxious, deeply uncertain about the future, are constantly being told that more Europe, more integration, and unification is needed and required. This is something with which I personally happen to agree, but which falls quite often on deaf ears among the public in Europe who have a sort of integration fatigue setting in about Europe, and in any case wonder whether it is not in fact a pipe dream to turn into a single political entity what remains of a union of democracies in Europe. I am going to stop there, because I think if I get any more drawn at this stage into the details of this complexity, you will never will able to shut me up. And that would be a shame, because we have a large panel consisting of many people with interesting things to say including, I suspect, about Europe.

J. Harding:

Thank you very much, Peter. I do hope we can get back to that issue. It is quite striking to hear David Lipton say we need a swift and comprehensive settlement of what is going to happen in the fiscal and banking union and to hear you talk about the very deep political disagreements that are preventing that from happening. I would like to turn to Oleg Viyugin. For Russia, sitting and watching Europe and watching the impact the latter is likely to have on the Russian economy, and given the issues the face Russia’s economy itself, I would like you to give your thoughts on where we are going.

O. Viyugin:

Thank you, James. Actually, deleveraging is obviously necessary when we are talking about specific parts of the global economy. Measures that are implemented by the major regulators and authorities now look merely like short-term measures to prevent this hectic or tough deleveraging and the consequences of such promises. This means that, actually, the short-term measures do not show us the light at the end of the tunnel. This is a big problem. Taking into account the low interest rates, investment is disoriented and it is very difficult to make the right decision if you have a large amount of money for investment. The run towards quality is reasonable in the short term. However, in the long term, it is a run to anywhere. From this point of view, what can emerging economies and specifically Russia do in this situation? The situation in Russia is completely different. The debt burden is not so heavy and not significant enough to be involved with the same problems as advanced countries. This means that the potential from the point of view of many investors is quite good. It seems to me that Russia and other emerging markets, such as China, Brazil, India, possibly Africa, altogether have a unique opportunity to obtain many resources in order to create a jump in the future. The only obstacles are risks related to quality of regulation and quality of the state agencies. Some may have political issues, which can become an obstacle for big investment. We have a situation where money, which is running against across the world, is looking for some sort of safe haven, could be channelled with bigger risk into the emerging markets and developing economies. Of course, investors have to take risks. The only obstacle to stimulate investors to take this step is regulation. If, for example, Russia will be in a position to overcome the problems that are now located in the quality of regulation and the quality of the legal system, then it is possible to use this unique opportunity. This is not just about Russia, but also about other countries. From my point of view, it is one of the options for recreating and restoring sustainable economic growth in the global economy without painful deleveraging in the advanced countries. Of course, you can say that I am a dreamer, because sometimes it is very difficult to improve regulation and increase the attractiveness of economies in a short period of time. Maybe this is so, but it is one of the options for avoiding very serious and painful changes in the future because deleveraging is necessary. Any attempts to prevent this process, this therapy, is very provocative and can bring about negative consequences, such as the distortion of the investment objectives, and so on. That is my point of view.

J. Harding:

Thank you, Oleg. Thank you very much. This is clearly one of the essential questions. How do you manage the necessary deleveraging without choking off the growth in the short term that Tharman mentioned to begin with? On that note, I would like to turn to Mark Haefele, who runs investment for UBS and probably knows a fair bit about how you marshal those private sector resources. There is USD 1.6 trillion under management by UBS's Investment Division. How do you get that money moving, Mark?

M. Haefele:

Well, certainly private investor capital and private investor confidence is key to the road ahead. In addition to the USD 1.6 trillion of private capital that we manage, we bank one out of two of the world's billionaires. In all the conversations that we have with our investors, they are concerned in the short term that we are going to see a global slowdown and they are concerned in the medium term about how this developed market or developed country sovereign debt issue will see some resolution. I think that in the shorter term, we as a firm are slightly more optimistic than many investors. We think that in the European situation, they will walk closer to the edge of the cliff, but then the eurozone will stick together, and they will continue to muddle through. We think that in the United States the sub-trend growth will continue. We will not fall into a recession. And I think in China we are perhaps the most optimistic. We think that many of the small reforms that have taken place over the past few months are going to start to show up in the data in July. We are going to start to see a bit of the economic growth returning there. So, that is in the short term. In the medium term, looking at this issue of sovereign debt, I think one of the things we are looking for are the different levers that can be pulled to get us out of this. We think that, ultimately, it is going to lead to something like eurobonds, that is, more neutralization of debt or some losses being taken by some parties. Two other key portions of this way out are going to be continued financial repression, that is, sovereign interest rates kept at unusually low levels. Inflation is also going to have to be an important component of the way we work our way out of this. Thank you.

J. Harding:

Thank you, Mark. Thank you very much. We will come back to those issues, particularly the last two, shortly. I would like to turn to Sri Mulyani Indrawati, who brings a very particular perspective, not just as a former Finance Minister of Indonesia, but also as a managing director of the World Bank, both understanding the domestic politics that are at play, but also the international policymaking perspective. Sri Mulyani.

S.I. Mulyani:

Thank you, James. I tried to listen, especially from Tharman, to the ways in which we can restore growth back to normal. Especially in the past three decades you see, for example, that China has had a double-digit or 10% growth, which is very impressive. Most developing countries have actually developed their growth from 3% to 6% and that was mainly driven by their exports or external demand, which is actually growing at about 10%. That external demand is actually coming from advanced countries, which are now having all these problems, whether in Europe, the United States, or even many advanced countries in Asia. Now the question is actually whether there is really a decoupling or if we are talking about the new paradigm: whether these emerging, middle-income countries can become the stabilizing factor for what we call the short-term situation now. Of course, because of this link with external demand many of the emerging countries are now suffering from what could be called a weakening growth. You can see that the export growth is now declining. Whether this is also reflected in the natural resource price or commodity price, you see that oil prices are suddenly shifting and commodity prices also declined quite sharply. That will hit both oil-producing countries and African countries, which in the last decade have had a very impressive growth of more than 5%. That has never happened before. This is a question of changing the growth model. In the case of many developing countries, they should not depend more on external demand but use their own domestic demand. This will not be easy. In the case of China, it means they have to rely more on consumption, not on investment that is directed to export. That will change the social policy or even, in this case, their local policy of education and health. Many other middle-income emerging countries are actually also faced with their own structural problems. We should not forget this. Now our attention is focused on Europe, as if the problem is only in Europe, and middle-income countries look relatively bright. However, if you look closer, 70% of poverty is still in middle-income countries. If you talk about BRIC countries, it is actually there. And we must talk about the structural situation of many of these developing countries, whether we are talking about regulatory frameworks, institutional quality, or dealing with infrastructure quality. These still need to be developed. I think in a way there is an opportunity because of this problem, for middle-income countries to look more at their domestic growth model and should simultaneously address their own structural problems, with improving quality meaning that they can generate growth from this infrastructure development. At the same time, the most important lesson from this crisis in Europe or the United States, or other countries that are highly exposed because of sovereign debt, is that these emerging and developing countries should carefully manage their growth model. This should be done not through accumulation of debt, but through more on productivity-driven growth. This means investing more not only in hard infrastructure like roads and electricity, but also in soft infrastructure which is human capital, institutions, and the regulatory framework. That message needs to be conveyed there, so that we are not too optimistic, but also at the same time not too pessimistic. In short, we are now dealing globally with rebalancing growth. And when you talk about rebalancing growth, it does not only mean that the ASEAN emerging countries should consume more, while developed countries should save more, but it is also related to the homework by all countries to focus on their structural problems. Therefore, if global growth is to be sustainable and balanced, it should be driven by productivity, innovation, and good quality institutions.

J. Harding:

Thank you, Sri Mulyani. Thank you very much indeed. I think that gets right to the very heart of the issue. Listening to all our panelists you can hear these tensions between releasing the private sector and not using the public sector to impede that growth, between doing what is in the interest of the short term and keeping an eye to the long term. The real question is – and I am going to turn to you, Alexei Kudrin – if in the next couple of years you cannot expect much growth out of the advanced economies, what do you do in the emerging economies? In that sense, I would like to start by asking you two questions about Russia. Russian growth is obviously better than Europe’s, but it is quite a bit slower than the other BRIC countries. What do you do to raise the Russian growth rate and how do you change the quality of Russian growth, the levels of public spending, and the extent of state ownership? Alexei Kudrin.

A. Kudrin:

Thank you. Before the crisis, from about 2000 to 2008, the Russian economy grew by an average of more than 7% of GDP per year. These are good numbers, but we should not forget that half of this growth came about as a result of rising oil prices and increased production of oil and gas. Today, the trend is different: we will no longer see increases in oil production. Old fields are gradually being depleted, and new fields cannot take over at the same volume of production. The significance of this sector as a source of growth has declined significantly. In addition, I assume that it would be imprudent to count on oil prices continuing to rise at the same rate as we have witnessed over the past ten years. When I became Finance Minister in 2000, USD 20 per barrel seemed to be a blessing for our economy, since the average price per barrel over the previous decade was USD 18.50. At the peak of the crisis in 1998 it dropped to as low as eight dollars. Currently, we have no reason to expect oil prices to rise significantly. It is likely that energy-saving initiatives play some role in this. Oil prices may not fall significantly, but we do not expect a large increase. The rise in oil prices is no longer as significant for Russia as it was in the past.

Our status as a demand economy has been another factor. We boosted demand through means such as government monetary expansion. We cannot now hope to sustain this as a stable and long term factor. Our growth was not based on competitive, quality products finding their niche on the global market. The last ten years of growth have resulted from an expansion of consumption. We must create a new growth factor, one of higher-quality manufacturing which can compete with comparable products around the world. This requires a good macroclimate, and we must create an efficient regulatory regime.

As Oleg stated, the judicial system is responsible for creating the basic opportunity for any business to operate comfortably. The quality of the workforce, education, and the capacity for innovation are also important. Here, too, we have a great deal to learn. We have set ourselves a goal, but there will be a long journey before we achieve the needed results. This is why we are now looking at a new model for economic growth. We are tentatively calling it a transition from a demand economy to a supply economy, with a view towards high quality supply – a higher quality of Russian production. As a result of all these factors, our economic growth in the next few years will not exceed 4%.

J. Harding:
But that's exactly about what I wanted to pick you up on. How do you explain, there's clearly now a storyline to what Russia is planning to do. We heard from the president yesterday that the country is not committed to state capitalism, that it wants to see greater private sector investment, and yet what you see in the last few years is an increase in the state role in the economy. How do you explain the difference between what is been said and what is actually happening?

A. Kudrin:
I believe that the President has correctly identified the tasks at hand. The question is how to proceed from merely defining goals to actually achieving them. This has always been a tricky problem for us. The processes of decreasing the government's footprint and creating a better regulatory environment are both still very flawed. The extent to which the government and the President are able to consolidate their team will be crucial for our ultimate success in solving these problems.

J. Harding:
Thank you very much. Hu Shuli, I will turn to you because, of course, in China there is if you like a different version of the same problem. Money flowing through the state sector, an easing of credit to state-owned enterprises, and the extent to which

this is drowning out private sector investment is a concern when it comes to the quality of Chinese growth. What is your assessment of that problem?

Hu Shuli:

Okay. I think the economic behaviour in China seems to be really good compared to the rest of the world, especially compared to the developed world. However, there are deep problems. We have to understand the reason why China has been developing so well in the past decades. I think this is mainly because of three kinds of premium. First, China started from a very low beginning point. Therefore, there is a premium for economic reform – the opening up. The second premium comes from globalization and the very positive external demand, of which China is, I think, one the largest beneficiaries of globalization. The third premium for China is the demographic dividend, or simply put, cheap labour. At least two of the three premiums will disappear in the coming years. This is very difficult for China. China has been talking about changing its growth model for at least 15 years already, and still China has not been able to change it. Right now in China we say that the growth economy is declining, but it is still at a very reasonable level. People are discussing a soft landing and a hard landing, or no landing at all. There are very strong opinions, which are very different from the rest of the world. I understand that the world observers always say that if China has a soft landing, this could be very helpful for the world. However, in China there is a very strong opinion that perhaps it is better for us to get hard landing instead of soft landing. Why? Because if we can land as opposed to crash, then that would be a good thing. A soft landing means that we might get a sense of the crisis in a potential way that can provoke in-depth reform. China has everything but a sufficient sense of a crisis to push it towards in-depth reform. Reform is so difficult without it. We always talk about goals, like the 100-mile goal, but we have reached only 90% of it, and this is the same as only reaching half of it. That is a real problem for China. China needs more challenges to get in-depth reform. We know that we need structural reform, political reform, or further liberalization such as equal access for the private sector and everything. The question is: how do we do this? That is all.

J. Harding:

Thank you very much. Tharman, do you want to talk about this question, particularly regarding structural reform in the middle-income countries?

T. Shanmugaratnam:

Yes. I think the common theme coming up in our discussion, which Mr. Kudrin highlighted particularly for Russia but is the same theme for advanced economies and the same theme that Sri Mulyani addressed for the emerging economies, is that of supply-side driven growth. It is about skills, it is about institutional reforms, and it is about dealing with the looming demographic challenge. Let me just highlight two points. First, I think a big priority – and you really have to think big about this – is skills. It is completely unacceptable to have levels of youth unemployment in advanced economies of between 25% and 50%. This is just completely unacceptable. You have to remember – and all of us know this not as economists or politicians, but every ordinary person knows this – your youthful years are when you accumulate skills for life. If you do not accumulate skills in a job during your youthful years, you might never be able to lead a normal life in the future. It is very critical that we attack this problem aggressively in the short term for long-term benefit. As regard to emerging countries, which Sri Mulyani rightly said, a key challenge is productivity, let us remember that despite everything that has happened, China's level of productivity today is 15% of the United States. India's level of productivity is about 5% of the United States. Even the few countries that have broken out of the middle-income trap are still something like 65% to 75% of the most advanced economies. Singapore, Korea, and so on, we are still at about 65% to 75% of the advanced economies. So, still some way to go. We think of the emerging countries as having a great advantage because, except for China, they are young. If you leave out China, if you look at the Middle East and North Africa, look at Sub-

Saharan Africa, at India, Latin America, Southeast Asia, the remarkable fact is that one third of their populations, or about 30%, is below the age of 14. We think of this as a great demographic advantage, a demographic dividend, as they say. It could equally be a demographic disaster because on current policies, current levels of investment in education and training, we are simply not preparing this bulge of population in the emerging world to take part in a globalized marketplace and have the confidence of earning their own living with their own skills and enterprise. We are just not prepared for this. The levels of investment and, to take Mr. Kudrin's point, the quality of investment in education and training, not just the overall size of the budget, is still very weak. On current policies this is looking more like a disaster than a dividend. And then you have the other side of the demographic spectrum, of China, which is going to get old while it is still relatively poor and the advanced economies where, as we know, social security systems are soon going to be insolvent. They are literally insolvent. In the United States, within the next 18 to 25 years, the Social Security trust fund will be insolvent on current contribution rates. So, either you have to jack up the contribution rates of the young considerably, which is extremely hard to do, because with smaller populations of young you need much higher payroll taxes, or you are going to have to reduce benefits, in a way that is going to be politically extremely challenging for the old. Most democratic systems have favoured the old because they vote and the young do not vote. The next generation is not around to vote. That is a real challenge for democratic systems. How do we solve the demographic problem of aging in a way that is not so short-sighted and not so irresponsible?

J. Harding:

Can I just ask you a question on that first issue, the youth unemployment issue? When you say let us deal with that aggressively, that fits squarely into your issue of how do you do something in the short term that does not lumber you with really long-term problems?

T. Shanmugaratnam:

Right. I think that, basically, both in the emerging world and in the advanced world, we have seen a drift in the last 20 to 30 years towards the academic, towards forms of academic tertiary education. We have seen a tremendous bias towards regular styles of university education. But, the fact is if you look at the United States and Europe today, very large numbers of unemployed graduates are graduates doing jobs at a pay that is not normally associated with graduates. And they are really relatively simple jobs: clerical jobs, lower-level technical jobs, deeply dissatisfying. After investing family resources and a length of time in your youth in a university education not to get a job that you thought was worth it is deeply dissatisfying and a great waste of resources. Likewise, if you look at China today, a booming economy with 8% to 9% growth, there are very high levels of unemployment among graduates. The same goes for India and the emerging world at large. We have got to reorient our concept of training towards skills and towards applied training. You can take this to a very high level, but it has to be related to a job, preferably in the job or in close association with employers. The Germans and the Scandinavians have a working model with apprenticeships, dual education, internships in industry. You can develop on that. Some smaller emerging countries like Singapore have also had a very strong focus on technical education. That shift towards the academic, which is something that many countries have blundered into in the last twenty years, has to be reversed.

J. Harding:

That is very interesting, thank you. I think all of us would feel that we have come to St. Petersburg and learned something very useful if we left knowing what was going to happen to Europe in the next six months. Therefore, given that we have both Lord Mandelson here and David Lipton and, in fact, a number of other people who have some real insight into what is happening in Europe, I thought I would ask a really simple set of questions of what will happen in the next six months. I will start with Peter Mandelson. The questions are the following. Will Greece leave? Will there be a sovereign bailout of Spain and Italy? And will there be a structural change in the arrangement between the members of the eurozone? Peter Mandelson.

P. Mandelson:

These are very good questions. Will Greece leave? Not necessarily, but if it does, it will not leave immediately, and huge efforts will be made to ensure that it leaves in an orderly, not chaotic way. There remains a question mark over that. Will there be a bailout of Spain and Italy? Well, you already have strong financial assistance being extended to both countries. However, if you were going to see the banking crisis in Spain transferring to Italy and both sovereigns being unable to fund themselves from the market, it would be very difficult indeed for the eurozone as a whole to finance both Spain and Italy in those circumstances. It would not be impossible, but very hard to see without the European Central Bank essentially resorting to the printing presses and printing money in order to cover what was needed. That, of course, is an anathema to Germany. It would bring all sorts of risks and perils of its own and therefore it is by no means a straightforward or simple solution. But, do not underestimate the political will that exists among eurozone members, both among their political elite and among their publics to sustaining the economic and monetary union, which is now absolutely the heart of the entire European project. Will there be structural changes? There will, but again they are not going to take place over night. I think you will see at the European Council taking place next week, on June 28-29, a working plan – if I can use that term – which the President of the Commission, the President of the European Council, Mr. Van Rompuy, and the President of the Central Bank, Mr. Draghi, are working on. They are trying to hammer out and secure an outline agreement to the working plan from the heads of government of the European Union. I think after that you will see in the coming six months that working plan or outline, those building blocks, or working methods, which they will want to see agreed by the European Council at the end of next week, being turned into an operational plan, an implementation plan.

I believe this has to emerge before the end of this calendar year for any chance of credibility being restored in the eurozone and any chance of that very important bridge to the future being put in place that will give the markets the confidence that this incomplete project – if I can again describe it in that way – is overcoming the original design faults or flaws that were incorporated into it from the very beginning, and that they will be rectified. You have two orders of very challenging and very intense activity facing European heads of government. What to do to get from here to the end of the year and what bridge to place from this year into the future, through a reconfiguring or remaking of the eurozone that has to be taken forward from this year onwards.

J. Harding:
Thank you, Peter. David Lipton, what is your view on what will happen between now and the end of the year?

D. Lipton:
Let me start by saying I do not have any answers to your questions and I do not think anybody else does. I would therefore rather approach this by talking about what ought to happen. I think it is clear that it is best for Greece and best for Europe if Greece continues its adjustment programme and does all it can to stay in the eurozone. Deprived of the package of support that they presently have, they would have to make much more harsh, much more rapid adjustments and in that setting, particularly if it became a disorderly situation, the impact on the rest of Europe would be adverse. So, it is in Greece's interest and in Europe's interest to find a way to carry forward. When you look at Italy and Spain, I think both of those countries have made admirable efforts to address their problems, their fiscal problem and their competitiveness problem. I mentioned earlier that the deleveraging challenge is one that, in Spain, will be a continuing challenge. These problems will not be resolved immediately. But, you have two countries that are doing what Europe has asked of them and yet the markets are not convinced. I think this is a situation

where Europe more broadly has to ask itself: must we not help countries that do everything that we ask them to do? If not, what story are we supposed to tell to a country that falls into trouble? Linking this to your third question about the structural set of issues, I think there are things Europe can do to make sure that countries like Spain and Italy, that do what they need to but have to persevere for a long period of time, get some help and do not fail in a way that causes major problems for all of Europe, first and foremost, in the area of banking. You asked about bailouts. Well, Spain has not gotten a bailout but it has gotten some financial support for the recapitalization of its banks. It is very important that Europe provide ways for countries to deal with their banking problems that do not put such a heavy burden on the national finances that the country fails while trying to address its problems. Deposit insurance is another example. If there is a run on a national banking system and that nation does not have the fiscal wherewithal to stand behind its bank deposits, that is a problem for all of Europe. So, Europe should find a way to prevent that problem, both in the interest of the individual countries and in the European interest. I think we will see moves towards consideration of this issue of financial integration with European-wide supervision to try to prevent the kind of refragmentation we see in banking sectors around Europe – deposit insurance and recapitalization schemes. That will not happen overnight, but some aspects of it can happen quickly. The question of the longer-term issue of whether there is a more unified Europe, a fiscal union in Europe, will surely take time to formulate and carry out. But, after all, there have been many projects in Europe that were a long time between the conceptualization, the political commitment to the idea, and the implementation, whether it is the customs union, the currency union, etc. But, it is very important to get started down that path. The sense of direction and the sense of commitment can have a very important impact on markets that I think are looking at this present hybrid situation and asking the question: does this really work? I agree completely with what Peter Mandelson said. One should really understand the depth of commitment in Europe to the European project. It is utterly essential from a political and an economic standpoint. I think that, as Europe mulls this over and realizes the stakes and the risks, that they will consider these architectural changes. And it is very important that they do so in a convincing way.

J. Harding:

Thank you, David. Mark Haefele and Peter Mandelson wanted to say something. Mark, you first.

M. Haefele:

Yes. I just wanted to talk about the confidence issue that has been raised. When you look at the market response, actions by the politicians have not impacted the market and have not had that much of a positive effect for a very long time. The actions by the ECB had instilled market confidence for a little bit longer. I think that that speaks a little bit about whom the market views as able to live up their promises and whom it views as unable to do so. I would be very interested to hear what the panel thinks about what might come up from the EU Summit. From our own view, we see a poker game going on in Europe where the peripheral countries hold a set of cards, Angela Merkel holds a set of cards, and the ECB holds a set of cards, and each one wants to play those cards. What many in other parts of the world fail to see is the importance that Angela Merkel puts on domestic politics. Actually, 80% of Germans are against Eurobonds and tighter integration right now. So, I think you have to take that off the table for a while, because she is looking ahead to the German elections in 2013. If you take that element out and we do not get much movement forward on that, I think that unfortunately we are going to have to see the ECB step up and do more, whether it is a rate cut, whether it is more LTROs. These are not necessarily going to be long-term actions, but that is why we lean towards the muddle through option, and we have less hope about finding a grand solution out of this EU Summit.

J. Harding:

Thank you, Mark. Peter, you wanted to say something.

Lord P. Mandelson:

I just wanted to add a postscript, if I may, to what David and Mark have said. Certainly, I think we are going to see from the ECB, Mark, phase three and probably four of LTROs, although God knows what sort of quality of junk is being bought by that means. You rightly mention Germany. Germany is absolutely pivotal to everything that you have said and also to the prescription that David Lipton has offered us. In effect, what David is saying, and I agree with him, is that a monetary currency union cannot exist without more unified fiscal and banking arrangements. It cannot exist without a 360-degree vision and role for the European Central Bank. I do not believe that the currency union, the eurozone, is sustainable in the long term without those changes to its structure and to its mode of operation being made. Here is the problem. Essentially, what David is describing, both immediately and in the long term, is not simply an economic and monetary union and a fiscal union. He is effectively describing a transfer union. This is a union in which, essentially, the strong come to the aid of the weak, and that that should be the operating principle of an economic and monetary union going forward. But, when we are talking about the strong coming to the aid of the weak we are, not entirely but to a very great extent, talking about Germany. Germany, not unreasonably, draws attention to three things. One, that it does not have unlimited indefinite strength or resources to draw on. You cannot stretch Germany so far, indefinitely, without something snapping or breaking. Secondly, Germany says that the weak members of the eurozone became so vulnerable to these twin banking and sovereign debt crises because to all intents and purposes they had taken the opportunity of enjoying all the cheaper and lower borrowing costs made available by the creation of the euro and the eurozone without making the changes to their economy – the economic and structural changes – to enable them to enjoy those opportunities indefinitely. In other words, they chose to take advantage of the euro in order to live beyond their means without making the structural changes to their economy that would enable them to do so on a sounder basis indefinitely into the future. Therefore, what Germany says is that you have to sort of heal yourself. We are not going to simply throw money and fund an elaborate and continuing transfer union without it being absolutely demonstrably clear, both to us and to your own citizens, that you are carrying out the painful changes and structural reforms that the rest of us have gone through in Europe, but which you for some reason, thought you were unable or unwilling to do. Thirdly, and lastly, Germany will say that, if you want us to accept a greater and central responsibility at the European level, that implies it requires some loss of national sovereignty or ability to determine your own fiscal and other policies. You are giving up, in a sense a bit of your national economic freedom, in order to enjoy all the benefits of that collectivization of responsibility, of assistance, of underpinning of your debt, bailing out of your banks, etc. And we, Germany, want to see how those arrangements are going to operate at a European level before we simply step on the conveyor belt of this transfer union without seeing how the disciplines and the controls are going to be exercised to make it workable across the eurozone as a whole. Fine, let us talk about the strong helping the weak. Yes, fine, there has to be a greater sense of a transfer union operating at the heart of the eurozone. But, let us have no illusions. Germany, above all has to pick up the tab for that. It is not unreasonable for Germany to say that for this to be sustainable and not simply a set of Elastoplast, a box of aspirin, and short-term panaceas that we are applying to the eurozone, the eurozone members who are weak and who have undergone the least successful structural and economic changes have to go through the very painful processes that we did. What is more, Europe as a whole must exercise the right and have the means to oversee that process. Therein lies the very complex politics of this situation. I am sorry to simplify it in that way and to make it very bald. That is the set of political conundra that operates at the heart of this multiple set of crises.

J. Harding:

If we are going to ask questions, I just wanted to ask one other question of Sri Mulyani before we go to questions. If you think about it, we have looked at the world this morning, and we have talked about growth in the emerging markets, structural changes necessary in middle-income countries, the problem in the advanced economies, particularly in Europe. I just wonder, Sri Mulyani, with your global view, whether or not there is something we are missing? Are we missing potential stories out of Africa, demographic possibilities, even another round of trade liberalization that might make a real difference here?

S.I. Mulyani:

First, I think what has been said is not new. It has been discussed publicly and it concerns the problem of the speed of solution or action with the idea of solving the problem of Europe. You mentioned six months. That is exactly the problem, with the market expecting six months, but the political process and the decision making, which is quite fundamental, is not going to take place within six months. That has always been the case for the past two years. What does it mean for many emerging developing countries? You see that the economic performance has been revised down for all of them in 2012. And this is only because of this uncertainty. Demand has become very weak. Your policy space at the macro level, whether you are using fiscal or monetary, is becoming limited and also too risky. For many developing countries, Africa in this case has a great deal of potential, whether you look at the demographics or the natural resources. If you look emerging countries in Asia and in Latin America like Brazil, in order for them to increase their growth by exporting natural resources, while addressing their demographic challenges, they have to face what Tharman mentioned. This is not just a demographic surplus or dividend but it will be a demographic disaster if they do not invest in the right education system, so that they build the right skills. Do not forget that in the past 10 to 30 years when we enjoyed a high healthy growth – Tharman called it a normal growth – we still saw a persistently high level of unemployment. We therefore had, in a way, a jobless growth. And that is exactly the challenge. If you recall in the Middle East, the Arab Spring was triggered by youth unemployment. In many other countries, youth unemployment is still the biggest problem. So, this is not only about restoring the level of growth, but the quality and the design of growth itself, as Tharman mentioned whether this is on a scale matching the job, as well as in terms of the inclusiveness of the process – because in the past it was quite exclusive. The financial and capital market were working very fast, giving a very high yield, and making some rich faster, but real productivity was not really following it.

J. Harding:
I want to make sure that people get a chance to make some quick commentary. We have just over five minutes left. I wondered if people have comments or questions. If you do, please feel free to catch my eye. There is a gentleman over here.

From the audience:
Thank you. I work for Caixin Media. My question goes to the gentleman from the IMF. A few days ago at the G20 Summit a group of countries agreed to contribute more than USD 500 billion to the IMF. The biggest contributors were Germany, Japan, and China. All of them are big surplus countries. Do you see a trend here? I would also like your comments on the United States missing from the list of contributors. Thank you.

J. Harding:
Great question! Tharman, David. In reverse order, please, and keep your answers very tight and quick. We are almost out of time.

D. Lipton:
Yes. I think that the IMF is very fortunate that a number of countries, 37 in fact, have come forward to lend money at this difficult time. It is often easiest for surplus countries to provide money in this kind of situation. I think over time we will see a regularization of our finances. There will be future quota increases and in time there will not be the need to rely on this kind of ad hoc borrowing arrangement. But, quota increases with the complexity and time-consuming nature of getting all 188 countries to agree on is not something that can be done so quickly. We are very

pleased that we have this set of loans that is going to help us be in a position to help any country that is affected by the crisis in the near future.

T. Shanmugaratnam:

I just wanted to add very quickly that I think the United States has indicated that it is committed to providing very substantial assistance, where necessary, through the Fed and through the swaps between central banks. This is actually a very important part in the solution to the crisis as well.

J. Harding:

Thank you. There is a question over there.

From the audience:

Thank you. I come from Sweden. I have one question for Mr. Mandelson. You described the eurozone in very tough words. It cannot exist the way it is now without a monetary union, without a fiscal union, without 360-degree supervision by the ECB. So, if I could ask you a personal question. How come you supported British entry into this dysfunctional zone very recently? How do you look upon that now? I also have a very short question for Mr. Kudrin. You are the only one on the panel who has lived through the reorganization of a currency union, the ruble area. Are you most scared or less scared about the prospect of some countries leaving the eurozone because of that? Does that make you more or less scared having seen this reorganization of a currency union yourself? Thank you.

J. Harding:

Those are terrific questions. Thank you, very much. Peter Mandelson, why did you back Britain’s entry into the euro?

P. Mandelson:

Well, I could give two sorts of answers to that question. One is that if we had gone in under Tony Blair's premiership and leadership we would have been able to contribute a great deal of his and Britain's common sense and help the eurozone pick its way through this minefield in a rather more successful way than it has done. Therefore, the eurozone lost something through Britain's decision not to join it, because we had a great deal to contribute. Alternately, you could say, as an answer to your question, that it is a good things Britain now is not in the eurozone, because it is in the grip of an anti-European government which is choosing to disengage and distance itself from Europe. The process of putting right the eurozone's problems would be made more difficult by having Britain amongst its ranks led by a government that has so little sympathy for the European project as a whole. Is that a good enough answer?

J. Harding:
Yes. Thank you very much, Peter. Alexei Kudrin, which is more frightening having witnessed or been party to the restructuring of a currency union, people coming out or people staying in?

A. Kudrin:
I have always been a supporter of the euro, and I see the emergence of this currency as significant progress for the global financial system. The euro has some very clear benefits. But now we are also seeing a series of problems which were not resolved at the time of the creation and implementation of the euro. First among these is the difference in productive capacity among the eurozone economies. It is impossible for the euro to strengthen in a situation where Greece has such a low productive capacity compared to other eurozone countries. In other words, the currency of Greece cannot and should not strengthen during a period of economic recession in that country. That would be a massive blow to the national economy. If the value of a given currency is not linked to the fundamentals of that country's economy, an additional imbalance arises from that fact. In this sense, Greece and

other similar countries gain very little from the euro in terms of added growth, since the economy is constantly under pressure from a strengthening currency. It follows, then, that the eurozone might need to include a smaller number of countries which are closer to one another in terms of productive capacity.

Secondly, it is clear that a stronger fiscal union is needed. A long road lies ahead in this direction. Germany must reconcile with the fact that it must transfer some of its sovereign powers to some supranational body which will deal with certain aspects of budgetary and tax policy. But these are highly politicized issues. The crux of the situation is that without a voting majority within the fiscal union, Germany will be forced to accept any decision arrived at by the body. As a transitional step, I suggest a renegotiation of the stability pact, which would start to move towards the creation of a new fiscal union with significantly tighter controls.

It is worth mentioning that at G-20 negotiations, in which I often participated, we discussed similar plans for implementation across the global economy. We are living through a global economic crisis as well as a crisis of global economic regulation. Many of the contradictions stem from the fact that the financial market is global, but centres of regulation are national. We must increase regulation of financial markets on a transnational, intergovernmental level, but this must be done with extreme caution. Aspects of the Basel III agreement and other documents make matters more complicated for financial markets. It is an extremely complex process. Nevertheless, I welcome the move towards fiscal union for the eurozone and the preservation of the euro, perhaps used by a smaller number of countries which are more compatible in their productive capacities and the development of the necessary institutions.

J. Harding:

Thank you very much. Tharman, one very quick final point.

T. Shanmugaratnam:

I think the very important question coming out of these very thoughtful remarks on Europe is whether “more” Europe is necessarily a “better” Europe. I think we have to take a step back and recognize that solutions for mending a crisis have to be consistent with what is going to hold for the long term. The litmus test is this. Is what we do now in terms of the type of union going to make Europe more competitive and is it going to hold politically, which is about electorates and populations? Just two days ago there was a European Court of Justice decision that I found fascinating. This said that from now on within Europe – everyone gets four weeks minimum leave per year, that is already the European law – if you fall sick during your four weeks you get additional leave at any other point in the year, because your sick leave should be taken on top of your annual leave. So, if you fall sick while you are on leave, you take additional leave. That is quite instructive, I think. There is a certain logic in which that happens on a European scale. Does it lead to a more competitive Europe if you have a social union, which is what a fiscal union is going to amount to? It amounts to a social union. What does this mean for new European entrants, the Baltic states, for example? Does it make Europe a healthier and more dynamic continental-scale economy, in the midst of continuing competition from China, possibly from a resurgent United States, and from the emerging world? It is quite a fundamental question and I am really not sure what the answer to that is. I am convinced that a banking union which solves an immediate problem has to be pressed ahead with. You give up some sovereignty over bank supervision, over the restructuring of your banks, and you get some deposit insurance in return. Some variant of that is absolutely necessary. But, to go beyond that and link every form of union with every other form of union – fiscal, social, political – as has been inherent in the monetary union, is searching for perfection. But the perfect may be the enemy of the good.

J. Harding:

Thank you very much, Tharman. Thank you very much indeed. I realize that we have run over time by a few minutes. I apologize for that. I apologize if some people had some questions. It seems fitting that we end this session with a question and thank you for yours there, Tharman. I would just like to offer a final word of thanks to all of you. I know these are weighty issues that we have grappled with this morning. Thank you for your attention. Thank you to UBS for sponsoring this panel session. But, most of all, thank you to our astounding group of panelists. Many thanks indeed.