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THE FINANCIAL SECTOR AND THE CHANGING GLOBAL ECONOMY

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Moderator:

Sergei Guriev, Rector, New Economic School

Panelist:

Lloyd Blankfein, Chairman of the Board, Chief Executive Officer, Goldman Sachs

S. Guriev:

Hello, everybody. Welcome to this session which is a conversation with a very distinguished speaker. I am very happy to introduce Lloyd Blankfein who is the Chairman and CEO of Goldman Sachs. Lloyd graduated from Harvard with an undergraduate degree then a J.D. He worked in the legal sector and then he joined Goldman where he worked in the Fixed Income, Currencies, and Commodities Division which he then co-led. He worked for a few years as the Chief Operating Officer and President of Goldman, and he has been running Goldman for almost six years now.

L. Blankfein:

It has been a little bit more than six years.

S. Guriev:

A little bit more than six years.

L. Blankfein:

It feels longer.

S. Guriev:

It feels longer, OK. In addition to running one of the best known investment banks – some people would say the best known investment bank – Lloyd is also a member of the Advisory Council at Harvard Law School. He is also on the Dean’s Council of Harvard University. He is also a member of the Advisory Board of the Tsinghua University, School of Economics and Management. There is nothing like that in Russia, but who knows what will happen next. Lloyd has come to Russia several times in recent years. However, this conversation is probably not about Russia but more about the future of the global economy and of global finance. Before we go to the future, I would like to ask Mr. Blankfein to go back, say five years to June 2007 before everything started. Looking at June 2007 – what were you thinking then? What were you expecting, and what do you think has and has not materialized?

L. Blankfein:

Sure. If I could just go back even a bit further for just one second. I have actually been coming to Russia for work for 30 years. I started at J. Aron & Company, a commodities firm, and I was coming here in the very early 1980s and it was a little bit different back then. It gives you some perspective about how the unexpected can happen, which segues us to five years ago. I defy anybody to raise a hand and say he or she could have anticipated five years ago the events that we have just been through. Or if you did know what we would go through over the last five years, I defy anybody that we would actually come out of it in as good a shape as we are. That is because five years ago, or four years ago, there was such a major trauma. You did not anticipate that, and once it happened everyone was planning for the end of life as we know it. Of course, people are building back and you can see the end of the crisis now.

S. Guriev:

In that sense, you are even more optimistic than you would think even if it seemed like it was the end of the world in September of 2008. When did you actually see the light at the end of the tunnel? Was it in early 2009?

L. Blankfein:

Well, there are two things. There is the short-term problem that we have to work our way through, which we are still working our way through. It is still painful and quite difficult. The solution is difficult and survival itself is difficult because there will be recrimination. There is imbalance and people are coming out of this crisis in an uneven way which is spawning a lot of resentment around the world, because some people have come out of it better than others and at a different pace. It does not necessarily correlate with who is good and who is bad. It is just that certain sectors come out more quickly and that is creating a very difficult political situation. In the longer-term view, when did I know we would come out of the crisis? I knew we would come out of the crisis the day we went into the crisis because when you go into these things the world does not come to an end. The fact of the matter is, all the trends in the world that caused the bubble in the first place – the rise of the BRICs of which Russia is a preeminent member, the demographics of the world, the creation of wealth, technology – all those things which spawned the bubble, frankly, were valid. So, even though valuations got ahead of themselves and there was too much credit and there was a bit of an explosion, those trends that generated the bubble are still valid. There are still technologies, the BRICs are still rising, wealth is still being created in the world. So, you could say that this crisis that we are going through – while severe – is a temporary phenomenon as all of them are. However, the general march of civilization is that things do get better. I think it is pretty vivid if you step back from it and you look at the macro picture in the world.

S. Guriev:
But then these trends now have to be reprised right? As you said, some valuations were a little bit too high. If you look forward from now, what do you think is going to happen to different parts of the world and different sectors? What would be your bets or informed guesses from where you are.

L. Blankfein:
I am not afraid of that ‘B’ word.

S. Guriev:
OK.

L. Blankfein:
We make guesses.

S. Guriev:

That is your job.

L. Blankfein:

Yes, it is our job to try to guess the future and then to have a contingency plan for when we are inevitably wrong. That is really what risk management is. One part of risk management is you try to be right, but the real part of risk management is how you minimize the damage when you are inevitably wrong. My guess as to where things are going is that people in the world are generally catching up and I have a strong conviction about this. The haves will grow, but will grow slower. The previous have-nots are going to start to have some and then start to have a lot. I think the weight of performance is going to go in the favour of those countries that are blessed with great resources under the ground, natural resources like oil and minerals. Also, and increasingly more important are resources above the ground which are great, dynamic, ambitious, and well-educated populations like in China and India. By the way, you can argue that Russia has both of them. They have natural resources below the ground and they have quite good resources above the ground.

S. Guriev:

What has changed in that respect? Previous have-nots did have resources. Some of them did have dynamic populations and they were still the have-nots. Now they are becoming haves. What has changed in the last 10 or 20 years? Why do we see emerging markets actually emerging?

L. Blankfein:

Sure, I think we have noticed the change in the last 10 or 20 years, but the drivers of the change have been taking place over a couple of generations. People do not often say this, but I think peace is a pretty good generator. I think the normal tendency is for things to advance except when things get derailed, and if you are going to derail the evolution to better things every generation or so, you are not going to make progress. But, if you are going to have enough people who work together, I think that that is better. Technology has been a general leveller. In other words, instead of the kind of investment you would make in big infrastructure which some people can afford and some people could not afford, if you can create the infrastructure that will allow efficiencies from a laptop instead of what previously had been a mainframe and an apparatus that no one could afford – that is a leveller. Look how technology has levelled. Take a country like India that had horrible infrastructure. No roads, but guess what? You can export electrons. If you think of the businesses that grew up there that get driven, intellectual businesses that get driven by access to the Internet, where you export ideas and performance. We have thousands of people in India that are doing operations work for Goldman Sachs around the world from India. And guess what? They do not have to deliver it over roads. It goes right through the Internet. So, technology is an example, as is the free movement of people – people getting educated and learning about things. I think the rise of trade, open trade (and this is an obviously more controversial thing now), in a way, the post-World War II trade and openness, and supranational agencies set the stage for more trade, more exchanges of ideas, and really flattened, levelled, and opened up the world. That has been very important for the second half of the 20th century and we are getting the benefits of that now.

S. Guriev:
One surprise for economists during the great recession – we call the last crisis the great recession – a lot of people I think expected a rise of protectionism, which did happen, but it happened by an order of magnitude lower than expected.

L. Blankfein:
Sure.

S. Guriev:

That was a surprise for many economists. Did that not surprise you?

L. Blankfein:

It did. Again, I do not want to sound so optimistic that somebody would think, “Oh my goodness, have you been drinking or something?” We definitely have problems, and problems sometimes generate bad reactions. We are going through a wave of protectionism now in some ways.

S. Guriev:

Right.

L. Blankfein:

I just want to say there are real risks to this. I just do not think the risks damage things permanently, but something could damage it long enough to be quite inconvenient and painful for us. One of the risks in the world now is the rise of protectionism. Two things are happening. As people get poorer, in other words as the economies go down, people think of themselves first, and so there is less trade and more drawing lines around your own thing. Secondly, one of the ways in which we got out of the worst risks of the credit blow up was that governments had to go in and bailout certain companies and had to make contributions and take a lot of risks. Well, if the government is going to take risks, you suddenly got reminded that firms that were international were international in their activities, but when they needed help they were awfully local because they had to go to their local government. In return, their local government asks them please as you shrink your balance sheet…

S. Guriev:

Shrink it there.

L. Blankfein:

… Shrink it there, not here, because we sponsored you so you cannot do anything to damage our economy. I know the financial services better – for all financial services firms to be global, that has stalled and contracted a bit. Do I think that it will be permanent? No, but it could last a long time. The point is, when things are going in a bad direction and if in one of these bad moments you get killed, when it gets better you are still dead.

S. Guriev:
That is true.

L. Blankfein:
So, the important thing is when things are bad and you cannot do certain things and you have to survive and you have to have a lower risk that becomes very important to get through those times, to have yourself better positioned for the times when the opportunities are in place. But, do not forget the opportunities come back.

S. Guriev:
Right. Coming to the financial sector, as you said that is the sector you know best. What is going to happen to that sector? What is going to happen to the financial sector in general and investment banks in particular? How are you going to make money? Where are the businesses coming from? What are these opportunities you are talking about?

L. Blankfein:
The fact that there have been financial intermediaries for about 6,000 years, in that same context I am saying a lot of things change, but a lot of things at the core do not change. We have a function to perform in the world. We will continue to perform it. There are obviously a lot of risks. There is a lot of different rule making that is going on now. But the nature of what we do – we raise capital, we match that capital to needs – that has not changed. In other words, people who need the capital come

to us and they make their case. We validate that by trying to raise capital for what we think are the good ones and we do not raise capital for what we think are the bad ones. Investors that have confidence in us use that validation in order to inform their decisions. If we were often wrong, they would not trust us, but because we are often right, they do. We do that. We also help intermediate other people's risks that happen to come up and we also help manage other people's assets as they move to riskier assets. Those are all functions that need to be performed as much now as they ever had to be performed. There will be tweaks and rule making, steps backwards, but as long as we are in those businesses, as long as we maintain our franchise, as long as we serve the interests of our clients, those that need the capital and those that have the capital to invest, serve them fairly and provide that valuable function, we will come out of this fine.

S. Guriev:

Yes, we will go into tweaks a little bit. As you mentioned, investment banks do a number of things for their clients. What would be the main driver of the profits for investment banks in the future? Asset management? Investment Banking? Sales and trading? Which countries? Which sectors?

L. Blankfein:

Sure. If I say that a lot of it is similar to what it was before, I do not want you to think that we are not thoughtful about this, that we are just lazy. I do not want you to think that we got out the old book because we are too lazy to write out a new book.

S. Guriev:

A 6,000-year-old book.

L. Blankfein:

Yes, in hieroglyphics.

S. Guriev:

Yes.

L. Blankfein:

In our business, the business I know best, we are going to continue to advise our clients. We are going to take risks for our clients. We are going to help them hedge their activity. We are going to raise capital and we are going to continue to invest alongside of them and thereby validate their activity. When people see us invest and they know how conservative we are with our capital, other people will want to invest in those things and those activities will get capital. What areas are we going to invest in? Forever, in all our activities, our success has been in advice, financing, and managing assets, and all the activities that we do correlate with growth. So, we are going to gravitate as we did before to the places in the world where we think there is going to be more growth. Obviously, there are places that are not growing, which are big economies where we have big franchises that are still very important to us. Certain parts of Asia are growing fast. Other parts of Asia like Japan have not been growing fast, but it is a big economy, so we will continue to drive our franchise there. Obviously, the United States is our home market, fortunately it also continues to grow, not with a BRIC's growth rate, but we are going to be very big there. Where are we going to look for our growth in the world? Eighty or ninety percent of the growth of our business – not the critical mass of our business now, but the growth – is going to come from those high-growth areas that we have identified, where Jim O'Neill wrote his initial essay more than 10 years ago and identified those countries as BRICs, and there are countries right behind that – the so-called 'next 11'. I think there is going to be more, not fewer.

S. Guriev:

OK.

L. Blankfein:

If you want to see where our footprint is going to be, look at the growth rates around the world and our footprint will correlate with the rate of growth in various places around the world, provided they have good open markets, with good rule of law, so that you cannot only invest and participate in growth, but you can enjoy the benefits of that investment.

S. Guriev:

You mentioned several things which are critical to the modern investment bank, and generally we are talking about technology, but probably most of all we are talking about excellent people and trust from the clients.

L. Blankfein:

Right.

S. Guriev:

To what extent has that changed in the last five years? Do you still attract the best people? Did the crisis affect your relationship with clients? You mentioned some sectors and some industries are enjoying more trust from the public, some less. To what extent is that a challenge? To what extent that is still fine?

L. Blankfein:

I could say “yes” to almost all those elements. The most important thing that we have to do is have the trust of our clients and engage our clients and right up there, is also to be able to attract and retain talented people, including people who pass through our firm and only stay for a few years. We hire a lot of people out of school. We train them, and some people come to our firm intending to stay 30 years and they stay three. Some intend to stay three years and they stay 30, but the point is that we get that flow of talented people in. So the answer to the question, given these tough times and the reputational pressure on our industry and us in particular, that has to have made that difficult. But I would say on both scores, we continue to see terrific people. We work very hard at it. It is not our right. We just do not lay back and it falls our way. We go to schools. We work very hard to recruit the best people and I have to say in the last recruitment class, the numbers are still the same. If we give offers out to people who get multiple offers, something like 88% of those people go to Goldman Sachs. That is very important and we watch that like a hawk. If that number goes down, then we worry a lot, but it is still good. With our clients, obviously, they were very stressed from the markets, very stressed from the industry, and guess what? They were stressed with our name also because there was a lot of reputational focus on the industry. We are at the centre of the industry that got a lot of attention, and of course with all the things that came out – hearings and focus and news stories, and seeing the pictures in the paper every day, which I am not that used to and I hope I get 'unused' to it – all that stuff created a lot of pressure. Now having said that, our market shares – which we also watch very closely because it is confirmation of whether our clients still appreciate us or not – not only did they stay high, but they are at the highest level. Why do we care so much about whether we are number one in banking, number one in equity issues? Because it is a validation, and if that slips we know there is a problem. So far that stayed very high for us, as high as it has ever been. But, I cannot tell you that there was no damage, because maybe five years ago our reservoir of goodwill was a swimming pool, maybe now it is a lot smaller. Maybe now it is a little puddle. But the point is all you could do is the best you can do. We work from where we are today and we run out. There were not a lot of benefits to the stress that we were all put under over the last few years. It was very wearing and difficult, and it aged us all, but one of the benefits was it made us have to run around and stay much closer to our clients and work harder than we ever had to do. We have got some muscle that we did not have before. We are not complacent, and I will tell you we are battle-hardened and battle-tested. If you had asked me about five years ago about the state of the world, would I have anticipated what our firm would have to go through, I would say, "No way". But if you then told me what our firm would go through and you would ask me how strong would we come of it? I would not have anticipated how strong you have come out of it given what happened. So, if I had a choice of going through that or not going through it, I would not go through it. But given that I had to go through it, I am glad we came out strong with the management team we have, the support we have, and the relationships we have with our clients.

S. Guriev:

Given what you are saying on the importance of the people who work in Goldman Sachs and the opportunities which emerge outside the United States, how does Goldman Sachs handle the challenge of being a global bank, but also growing into a much more diversified international bank, given its DNA in origin as an elitist Wall Street firm that is Anglo-Saxon in nature? How has that challenge been handled?

L. Blankfein:

That is really the essence of it all. If you look at Russia 20 years ago and Russia today, it is the same kind of a thing for a firm. Obviously it is much more important, much more critical, and much more difficult for a country than it is for an institution, but you have to have the same mind set, the same kind of flexibility, and you have to be nimble. A dozen years ago we were a private company with a small balance sheet. We were American, we were not a lender, we were mostly an investment bank, and largely a domestic firm. In that short time the space became big. You could say we became one of the biggest pure investment banks operating things identified with the BRICs. Two predecessors ago, I do not think anyone from Goldman Sachs travelled to Russia or China or any of these places, let alone have a big footprint and presence. You have to migrate. One of the things is, you said we were originally an American Anglo-Saxon firm, but we are not like that. One of the things we had to do was not find Americans that could go out and populate all these other places. We had to become, for example, English. My colleague, Michael Sherwood, sitting at the front, runs our European operations from London, so we are English in England. We are Japanese in Japan. These are partners of the firm. The most senior people in the firm not only make decisions about their region, but decisions about the whole firm, and they can have influence over the entire firm. Eventually, our office here is not as old as those other offices, but we will be Russian in Russia, and we are getting to be Chinese in China, and that is an important thing also.

S. Guriev:

I guess my question is actually going further a little bit. So, given that China is growing so fast and Asia will probably overtake the United States in terms of the size of business and the demand for financial services, do you think there will be a Chinese CEO running Goldman Sachs, and when?

L. Blankfein:

Sure. There will be as much of a chance of that happening as anyone running Goldman Sachs. That is the point. If our only ambition for a German partner at Goldman Sachs could be to run Germany for Goldman Sachs, we will lose that person to Deutsche Bank, because at Deutsche Bank you can run the whole world. So, in order to have the best person in Germany, that person has to have a chance of running the whole enterprise, not just his niche enterprise. Now that takes a little time. But you know something – we are in the next generation already. That will be the case where someone from any part of the world will have the opportunity to run the whole enterprise if he wants to. There are a lot of people in this room. There are press in this room. It is not always such an attractive position to run the whole enterprise.

S. Guriev:

Well, yes, I also run a university. I agree. Running things is tough.

L. Blankfein:

I not only have to find people who can do it. I have to find people who want to do it.

S. Guriev:

Yes, I can see that, but also talking about the people who run things – you are in a unique position because you talk to pretty much all the global CEOs in the world. What do they think? What is their mood? What is on their minds? Do they see the global economy coming out of the crisis, opportunities, and challenges?

L. Blankfein:

I would say not in every place, but for the most part around the world sentiment is poor. Everyone is very negative. They are negative because the sentiment is still being dragged by the crisis, and by the way, it is a lagging indicator. The sentiment is too negative. Look, when did the crisis in mortgages start in the United States? It started at the end of 2006, end of 2007. The highs of the stock market in the United States were in October of 2007. Months after, everyone thought that the subprime crisis had already started and had taken effect. We will undoubtedly have negative sentiment around the world well after the signs are that they are in recovery. But sentiment is important because sentiment leads to activity. So, I would say right now that the sentiment is negative. Global activity as a result is very low, and I could tell you, the sentiment is negative because of the many uncertainties in the world. People do not know what governments are going to be in place. There are issues on where governments are going to be, on changing policies in China, the United States, and all around the world. There are elections in many parts of Europe – the federal governmental structure in Europe, if not specifically in countries and even some countries that have just gone or are about to go into an election cycle. The election cycle this time is much more consequential because there are real lines drawn in terms of tax policy and real sharp issues, and so people are sitting a bit on the sideline, but they are sitting on the sidelines…

S. Guriev:

With a lot of cash?

L. Blankfein:

… With a lot of cash, because they have deleveraged. Sure, there are some problems that are lingering from the issues that started four years ago, but a lot of it has been worked through. There is a lot of cash with the result that when sentiment finally does change, it could change dramatically. Look, it is very dangerous for someone in the risk management business like myself to project happy thoughts out from here because there are a lot of risks. But I will tell you, it is also very dangerous to be too negative. If you want to know what would happen now that would confound many of the asset managers in the world who are responsible in managing money, what would be a big disappointment to them? It would be for the markets to go straight up from here – because everybody is what?

S. Guriev:

Betting on the other results?

L. Blankfein:

Not necessarily betting on things to go down, but waiting.

S. Guriev:

Waiting. OK.

L. Blankfein:

Waiting and underinvesting. I know markets are down in Russia, but markets in a lot of places are holding in due to the level of anxiety. By the way, because sentiment is so negative, and usually when you have surprises they are for the most part negative. If I get a call in the middle of the night and somebody says, “I have news for you”, what do you think?

S. Guriev:

You are scared?

L. Blankfein:

Do you think I think there is a 50–50 chance that that news is good?

S. Guriev:

As a CEO, I would say there is a 99% chance of it being bad.

L. Blankfein:

I would say the sentiment is so negative, and the expectations and the politics are so poisoned in some ways, but there is so much money out there. I would say that we are at a point now where it is almost symmetric and maybe even a little bit more, so that you can actually get an outbreak of good news that would surprise people to the upside. By the way, that is why people are so underinvested. You do not know, it is dangerous to be long and it is dangerous to be short. But again, if you otherwise bet on civilization and markets and economies to progress, they do that 90% of the time. That is a safer bet.

S. Guriev:

But the losses 10% of the time may be huge.

L. Blankfein:

It can be huge, and like I said, you have to survive it. But, I would say the risk now is that people are wallowing in too much negative sentiment. Again, there is a lot of negative sentiment. By the way, I am in a business where you spend 98% of your time working in your mind what you will do in the 2% worst case probability. I am in the risk management business, but if you ask me what we are doing, it is very different from what we are thinking. I do not have to worry about things getting better. That will take care of itself. I have to worry about contingency planning. I contingency plan for a lot of things I do not think will happen.

S. Guriev:

Judging by Goldman Sachs' survival through all of these difficult years, risk management has done reasonably well, or at least better than some competitors I guess.

L. Blankfein:

Yes, and being a good risk manager does not even make me smile, because I am worried about tomorrow.

S. Guriev:

Yes, many things can happen tomorrow.

L. Blankfein:

Yes.

S. Guriev:

Suppose we are sitting here five years from now and I ask the same question I asked you in the beginning. What do you think is going to happen five years from now in the world and in the financial sector?

L. Blankfein:

My best guess, considering the human condition, is to strive and be disappointed and be miserable. We will be miserable about stuff, but at a spectacularly higher level of wealth, education, and performance. By the way, let us talk about this crisis. I got out of school in the United States in the late 1970s or early 1980s when unemployment was 11% and inflation was over 11%. New York City was literally bankrupt. You could not walk on most of the blocks around the city. It was not so nice here in Russia either, and everybody is now saying how this is the worst economic crisis. Well, I got to tell you, considering where I started out 30 years ago, we are miserable now at a much higher level of success than we were miserable before. So, the human condition is that we will always be disappointed, we will always strive, we will always have ambitions out of our reach. We will be miserable, but we will miserable at a higher level of performance. Why am I saying this in advance? Because look at what is happening. The people who were burdens on the economic system for a century are now making the biggest contributions in the development of that system. I think there are other trends in the world that are good. We are finding more energy. We thought we are going to run out of energy. Guess what? We are not going to run out of energy so soon.

S. Guriev:

That we know and Russia is watching that very carefully.

L. Blankfein:

In the short term it affects the price of the commodity, but the future of Russia is to diversify its economy anyway, and everybody is better off if wealth is pumped into the system somewhere else. If anybody gets richer anywhere in the world, you have your fair share of getting a piece of that wealth by selling them something.

S. Guriev:

That is why I am in the education business and not in commodity business, and in that I agree with you. But generally, I am asking not a quantitative question like GDP per capita, or inflation, or unemployment. My question is more of a qualitative one. Do you think that financial sector will still be dominated by multinational firms?

L. Blankfein:

I hope so. I am sorry. Why did you say firms?

S. Guriev:

One. It will be one firm.

L. Blankfein:

I am not saying you are wrong, but I am just questioning the predicate of the question.

S. Guriev:

Exactly. I just read this book, *How Goldman Sachs Came to Run the World*, right?

L. Blankfein:

No. There is an embedded assumption, and obviously we will be competitive and it will not just be the firms of today. There are huge pools of capital forming in parts of the world where we do not associate, but every country is going to have to have markets. And by the way, some of the changes in the world – the increased capital that financial institutions have to have because of our recent experience – means that they is going to be more; not only financial institutions are going to develop in the BRICs where there is a lot of capital formation, but capital markets are going to develop. So, it is not just going to be loans that are going to be swelling up big balance sheets to the point where there are USD 3 trillion and USD 5 trillion, you are going to have to have capital markets where they are lending and securities and selling it on to investors so that capital gets recycled. You are not going to have this growth without developed capital markets. You are not going to have capital markets without risk-taking financial institutions.

S. Guriev:

I am also a great believer in finance and financial markets and instruments, but a lot of people actually question the idea that financial instruments have become too innovative and too sophisticated for policy makers to understand them, for normal people to understand them. To what extent do you think that will be resolved somehow? Because a lot of backlash during the crisis was about derivatives becoming too sophisticated, too far away, and too complicated.

L. Blankfein:

I think there is a lot to that and I think there has to be some compromise. Look, the regulatory pendulum is going to swing because of the trauma that we just had. Because it was recent, there will be a lot of tightening up of rules and the pendulum may go too far and make things complicated. We may have many simple products, and if those products can accomplish people's objectives, then the pendulum will start to swing back. Hopefully, it will not swing back into the red zone, but something nature being the way it is, when time goes away, we will try not to, but maybe people will get too complacent again. Not in my lifetime, because the trauma that we all went through in the last five years is going to be embedded in me for the rest of my professional life. So, we are going to have a lot of capital and we are going to try to keep things simple, but the world is not simple. When somebody wants to do a currency hedge, but only have that currency hedge in place if a certain commodity they are selling is below a certain price, but not have that hedge if the commodity goes above a certain price, you are dealing with a mathematically complicated hedge for a very simple complex and people will want bespoke solutions. I wish simple solutions could accomplish everybody's objectives, but they cannot. There will have to be some meeting in the middle between the complexity that people need in their complex businesses, but not so complex that the regulators cannot understand them, and surely not so complex that the people who are doing the hedges do not understand them. And it is not just that the regulators did not understand certain things, it is just that the designers of the hedges did not understand them. Will mistakes be made? Of course they will be made, but I think there will be more oversight and you are going to end up with smarter regulators because they have to be, and by the way, smarter firms.

S. Guriev:

One of the things you have mentioned was the regulatory pendulum. I remember 10 years ago after Enron and WorldCom, the pendulum also swung. But what happened was that the regulation got tighter only in the United States, but not in some other countries, and that was a competition of regulatory standards.

L. Blankfein:
Right.

S. Guriev:
One of the things which we are observing now is that regulations become increasingly global and if regulation is too tight globally, then where do we innovate? On Mars? Is that a challenge?

L. Blankfein:
It is a trade-off. If you asked somebody in 2008 right after the crisis, nobody would want to hear that because you were looking at the cost of a blow up and nobody was thinking about the cost to innovation.

S. Guriev:
Right.

L. Blankfein:
As time recedes, that is going to have to be a trade-off, and that is why there is a bit of a pendulum swing. One of the issues in regulation is that there is all this conversation about the firms being opposed to regulation, when actually everybody is for it. The biggest beneficiaries of sensible regulation are the firms themselves. I want everybody who I do business with to be a good credit and not a bad credit. I want good clearing mechanisms. The biggest risk we had was that a firm we had extended credit to would blow up. So, we want that safety mechanism. If you make it too safe, you have no innovation. If you do not have it safe enough, it is a dangerous situation. The best regulation would be better if final regulations were not made until five or six years after a crisis. So after the passion left, you would go

back into the record in a more clinical dispassionate way. After the Great Depression which was in 1929, you had the Securities and Exchange Act of 1933, 1934, 1935, 1937, 1939, 1941. That is how long it took, a dozen years and they did not start the process until four or five years later. That is why the regulations then were dozens of pages, but if you start regulating one year after when passions are raw and everybody is trying to accomplish everything and people are weighing the cost of the regulations, you end up with 3,000 pages and something that no one can agree on. So, perspective is good too.

S. Guriev:

OK. Thank you very much. We have time for a few questions. There is a question there. Can we get a microphone? Yes.

J. Harding:

Hello. This is James Harding from the Times. Thank you for making ‘being miserable’ feel so good.

L. Blankfein:

That is my resting state.

J. Harding:

We will just drill into what is happening in the eurozone in a shorter time period. Over the next six months, what will you read and what will happen? Do you think Greece should exit? Do you think there needs to be a sovereign bailout for France and Italy, and how confident are you in the French financial institutions? Thank you.

L. Blankfein:

I do not have the five hours that will take to give a proper answer. A lot of things can happen and so there are a lot of unknown factors, and I could tell you that I do not know. I mean, there are a lot of uncertainties, but from sitting here now, in my mind, I do not think that Greece should leave the eurozone. I think that contract should be on. It is very hard. You could weigh the question of who should ever have been in, but the consequences of getting out are a lot more extreme because you open the doors to other things that you would want to have beyond contemplation. When you are all in and you are committed, you have one frame of mind. If you entertain the possibility of going out, you are never quite sure of that commitment. Also, what would be the benefit? In other words, the ability to pay your debts; the consequences to Greece of too much austerity or not enough; the issues they have with their own population; and things that have to get done. All those issues pertain whether they are in the Euro or out of the Euro with the Drachma. The risks of default could be the same in either case. Why is it they helped by getting out of the Euro? How is the eurozone helped by having them out of it? Is the Euro going to suffer something on the border that is as miserable as is going to happen in Greece? Would it make a big difference to the aid that would flow in that direction or not flow depending on the politics in the rest of Europe, whether they were in or out of the Euro? I do not think so to any great extent. I think people should work hard to keep Greece in the Euro, but that is not to say that it will not go out, or that people will not reach to the conclusions or the costs will not be great, or they will not do what is necessary. So, that is my feeling on that. My best feeling is that the commitment to the Euro is total. In America you do not always live with that frame of mind because you tend to see things as economics and as a rationale of what should people do and incentives and costs and benefits. But travelling as I do throughout Europe, I know that the Euro is not just an economic contract. It is an ideology and it is a political compact, and it is driven not by the immediate issues, but is driven by history. The consequences of this not working are generational in terms of when you can redo it, and I think that there is a commitment there that could make it work. There are issues and you write about this all the time and I can waste your time by telling you what you say to us in your own pieces, but you cannot have it one way. You cannot have a fixed exchange rate and disparate policies and then no adjustment through currencies or interest rates. All those things have to be taken, but I think it either will have to split apart or you are going to have to tighten up the room for play between fiscal policies and other kinds of issues. You are going to have to have a stronger federal system to form a thing at the centre. You have to go one way or the other and because of what I said about the history, it is clear to me which way they are going to go. Am I sure? No, but that is what I believe.

S. Guriev:
Thank you. Are there any other questions? There is a question at the back.

From the audience:
Thank you for your insightful and inspiring conversation. Now, what do you think about the contemporary venture capital industry, especially Russian?

L. Blankfein:
Which capital industry?

From the audience:
The venture capital industry, especially the Russian one.

L. Blankfein:
I think venture capital has been a thing that you could have called anything over the years, but people are willing to take commitments and not only making investment of their capital, but more importantly, bring their expertise and their energy to invest. Venture capitalists, really, are contractors. They are like producers in a movie. They bring parts together. They have experience on how you make things and how things start up and how you get over issues and problems. They are a very important catalyst for societies, and I think that the Russian government has been very perceptive in thinking that we want to draw these people into our country, both on the venture side and in later stage private equity, because your people realize that

this is a good catalyst for growth. It is not just about the money, it is the experience and the expertise in driving business. It is the experience in the history, because when you have experience there, you ride through problems, little problems like credit bubbles blowing up and devaluations and other things that would otherwise cripple and cause people to withdraw. People in the venture capital business also know how to separate the value of a good idea from the short-term issues that come from a cycle shift. I think they perform a very important role in society and I know with complete assurance that Russia recognizes that.

S. Guriev:
We have time for one short “yes” or “no” question.

L. Blankfein:
It means my answers are too long.

S. Guriev:
No, it is just your time is too valuable. Also, in your business and in my business, ending on time is crucial.

From the audience:
Thank you for such a fascinating conversation. It is fascinating for a number of reasons. But one was the very refreshing concept that you made at the beginning, the comment you made at the beginning that the world is coming out of crisis. What are the reasons that you think that the world is coming out of crisis, as it is sometimes hard to see this coming from Europe? To make it “yes” or “no”, are you sure that the world is coming out of crisis?

L. Blankfein:
Am I sure? Yes, in the long run. Do I know that 2012 is going to be a good year? No. But, from where we are today, firms have a balance sheet of everything.

Government has less leverage. Europe is a tougher road. They are a little bit later in the cycle than where the United States is. I would rather be in China when they are trying to stimulate the economy after having purposely slowed the economy to stamp inflation. I would rather be at this part of the cycle than at the cycle where they were trying to slow things down purposely. I would rather be in the United States at the point where the balance sheets of banks, and the balance sheets of consumers have been as restored as they are. Frankly, growth is not as fast, but clearly we are seeing an ‘uptick’ on things and not a ‘downtick’ on things. In an investment bank, we take the risks in the world. I did not live here for 30 years in this firm by being Pollyannaish and just relying on optimism, but I also did not get around for 30 years by reading the last newspaper headline and then jumping out the window because somebody is shrill. We have worked through a lot of the problems that revealed themselves four or five years ago, not all of them but more than not. And I think we are on the recovery cycle and they do not blow a horn when everything gets better. You look back and then from a perspective of the future you can look back and say, “Oh, two years ago, that month, that is where it turned around.”

S. Guriev:

Thank you very much. That was a fascinating conversation. Thank you for your questions.