Questions and Answers

Following the formal presentation, Axel Weber took questions from the audience.

GUILLERMO ORTIZ: Well, thank you very much, Axel. You have given us as usual a very thorough, a very insightful, and a very rich presentation on very important aspects of the reforms of the international monetary system as well as the IMF. And you made it a point at the beginning of your lecture when you said you were not going to speak about the sovereign debt crisis in Europe, you predicted or touched on some aspects of this, including the fact that—and your view was correct to involve the IMF at the beginning—the IMF also has to play a very important role in sort of correcting global imbalances, of which, of course, the European Union is an important part. Although in aggregate, as you mentioned, the current account for the region is balanced.

Now as you know, the main subject perhaps in these meetings and one of the main preoccupations is precisely the sovereign debt crisis in Europe. And there have been important steps that have been taken. There have been the July 21 accords and so on and so forth, which will take a few months to go through. So one of the important questions is whether something else is missing, whether we perhaps need a lender of last resort in terms of the solvent countries in Europe and the only institution that can provide that perhaps is the European Central Bank (ECB), as a bridge to when the European Financial Stability Facility (EFSF) is fully implemented.

So, Axel, I don't know if you would like to expand at least partially on some of these problems that we are seeing before opening to the floor.

AXEL WEBER: It's one of the trademarks of your job that once you've been a central banker, you can never walk away from it. So let me maybe say a few things on the European situation.

I think I'd like to start with the point I tried to make in the end. The measures to be taken are not disputed. What is needed is firm implementation of these measures. So I think for the European situation, it's pretty clear what is needed. And let me go back to what I tried to say before about how to deal with global problems. The first action must always be

at the underlying root causes of the problem. Then you can talk about financial mechanisms at the international or at the European level to deal with the fallout if some of these problems emerge.

So what does that suggest for Europe? It suggests first and foremost that those countries where there is excessive debt and where fiscal balances are out of whack need a very fast-track program to rebalance their economies. So fiscal consolidation in those countries where the debt sustainability discussion is prevalent is a key input into any solution in Europe. It's just a *conditio sine qua non* for moving ahead, so European countries that have a debt problem need to work at reducing their debt. And when you're a minister of finance, you usually have two ways to do that. One is the expenditure side of your budget; the other is the revenue side of the budget. I have zero understanding for European debates, whether it is a sacrosanct discussion about parts of the expenditure or parts of the revenue. Everything needs to be on the table. And when everything has been on the table and analyzed and action has been taken, there is a residual if expenditure and revenues don't match. Well, in that case, you can talk about some short-term aid programs and support programs as they are in place. But let me repeat again: that is dealing with the symptoms. It is not getting at the core of the problems. We need to deal with the root cause of the problems in Europe, and that is excessive debt and the buildup of excessive debt in some of these member countries.

I'm not one of those that believe that if you only reduce the funding cost of dealing with legacy debt, you will solve the debt problem. My prediction is a different one. If, for those countries that have excessive debt built up over years and years, you reduce the funding costs for that, they will add more debt. They will not achieve the fiscal turnaround. They will continue in a similar vein as they have before. So, therefore, you really have to attach conditionality to some of these international programs.

And I'm quite worried about the current debate about throwing any conditionality out of the window, about just focusing on the cost of funding and continuing from there. The whole debate, for example, about a euro bond is just totally misled. It takes away the attention from what is really the action that needs to be taken, because as long as you have irrelevant alternatives on the table, you spend a lot of time kidding yourself that some of these instruments are a solution to your problem. The euro bond is an instrument where everybody takes their own decisions about expenditure and revenues, and they let the European level, the community, pick up the bill for the residual of that decision. No taxpayer in Europe would be advisable to go there.

So before we can talk about something like that, there needs to be a joint process for decision making on expenditure. There needs to be a joint process for decision making on revenues. There needs to be then a discussion on what defines "unavoidable" or "surprise shortfalls of revenues" or "excessive expenditure." And then you can talk after all these decisions about a joint funding of that, which moves the entire euro bond into such a European instrument that, if you have a European economy that is more like a United States or Europe with joint fiscal policymaking, could be an option. Unless you get there, it just prolongs the pain in those countries that basically by such an instrument achieve lower funding costs for their legacy debt and take that as a signal to carry on as in the past. It would be futile for the future of Europe, and it's just the wrong debate. And as always in politics, as long as you can afford to have the wrong debates about irrelevant alternatives, they delay policy action. And we should simply take those wrong discussions off the table and focus on the core of what needs to be done.

GUILLERMO ORTIZ: Thank you very much, Axel. So let me open this to the floor, please, first question there.

QUESTIONER: *Mr. Weber, I'd like to ask a question with a background that my first meeting, my first Jacobsson lecture, was in the year 1968 and most of the IMF I attended. And I only have a very short question. Isn't the less polite message that you present and with your personal decision, isn't that after the first—after the banking crisis broke out in 2007 and we have now the big European crisis or mess since last year—that as journalists we can summarize that in the first crisis with the U.S. leading and in the second disaster that is happening in Europe governments being totally pressed have in part been destroying, politicizing, instrumentizing, muscling the central banks of this world?*

AXEL WEBER: I'm not a journalist, and I wouldn't want to describe how you do your job, so you can summarize my lecture in any which way you want. But I wouldn't associate myself with your summary.

QUESTIONER: *I've got a question which goes to the heart of what you were saying about the funding of the IMF, because there are some people who say that the IMF has overextended itself in the direction of Europe, that there was a large amount of lending going on there as you know. And there are alternative mechanisms being talked about. The rather innocuous-sounding AMRO,*

the ASEAN Plus Three monetary research office set up in Singapore recently, which could, if developed, turn itself into a kind of Asian monetary fund. There could be a diversion of funds from central banks and monetary authorities in Asia to such mechanisms under the Chiang Mai Initiative. One hears very interesting debates about how the Chiang Mai Initiative might itself be leveraged, could raise money on markets, and so on. This could set itself up as a kind of alternative mechanism to the International Monetary Fund with the Asian countries, which have the lion's share of the reserves these days, actually putting money into different channels, into areas which they think might be more propitious for the development of the world economy. And it could actually, I think, be quite an interesting salutatory in competition to the way the still largely Western-dominated IMF runs its affairs.

So let me get it from a raw, academic, historical point of view. Do you think you could give some thoughts to that series of reflections?

AXEL WEBER: Well, you just mentioned the right word, sort of almost at the end of what you said—it's competition. Clearly the IMF has a history of competing with local institutions, with regional institutions, that have similar remits. And to be honest, the IMF always managed to emerge from these debates as the prime institution that has the key expertise internationally. So, whilst it is an endeavor that countries should embark on, if they have a regional development bank and if they put research and expertise into these institutions, it is a long haul and uphill battle to come to the same standard of research and analytical capacity as the IMF has. So, I mean, take the IMF as a role model. Try and build regional funds with the same remit or similar remit and with the same capacity of international expertise—great thing to happen. And I don't think the IMF would fear the competition coming from there.

Let me also say the IMF—and that's a second dimension—is the only real global institution that we have. Regional institutions may supplement IMF action, but when we come to the next crisis, given where we are now—the world is now so globalized in financial markets, is so globalized in trade. It is so globalized in the provision of knowledge and technology. You just need to be in a university like Chicago where I am now. You rarely have 10 percent of your students coming from the United States itself. So we are in a global, knowledge-based society with global financial markets and global trade. Regional institutions cannot cope with the next crisis that will come because if one thing is clear, it is that the next crisis will not be less global than the past crisis has been. I don't really see that we will go back in international integration to any level that would allow a

regional crisis of reasonable size to be contained simply by regional action alone. And there I think we shouldn't kid ourselves. That's not going to happen again. So the IMF's role is key.

I wasn't asking about any reduction from where we are now in terms of the IMF. I was simply cautioning in two directions: one is that throwing ever larger funds at the problem is not usually a good solution if you don't deal with the root cause. And I think some of the discussions about funding extension may lead us astray at focusing at the real issues that underlie.

And the second issue that I think really is very important: the IMF has a huge capacity for analyzing problems and being blunt to member states about telling them how they view the situation. And to go back to the European situation, without the IMF's involvement, do you really think that leaders around the table—peers—would have come up with tough measures on some of the programs that have been embarked on? I rely very strongly on the IMF as an independent source of conditionality because on the IMF Board, you don't just have Europe, you have emerging markets, and you have all of those countries in Asia and South America that have been subject to conditionality in previous crises. And I think it is a very good idea to not waver on the standards of conditionality that were imposed on those crises on those countries and to continue imposing the same standards even now that the crisis is more an industrialized economies' crisis. And I think emerging markets sitting on the Board of the IMF can ensure a high level of required conditionality. And that is why I think it is important to have the IMF involved in the regional problem in Europe.

GUILLERMO ORTIZ: I think we have time for one or two questions, please.

QUESTIONER: *You highlight the good academic resources of the IMF, and you had some really nice words. Last week the IMF asked the European Central Bank to continue or maybe enhance the securities market program. Would you say that is also a result of good academic work, and do you accept that?*

AXEL WEBER: I was talking about the average suggestion, not each individual suggestion. But I don't think I have to embark in a very long and extended way on what I view as sort of the borderline between fiscal policy and monetary policy.

Let me just repeat my position, and I've held that throughout, and I'm still of the same position. If we want to deal with the root causes of prob-

lems, we need to make a clear analysis whether those problems are in the central bank remit or in the fiscal remit. Dealing with liquidity crises is a key central bank remit, be it international liquidity, then it's swap lines, be it national liquidity, it's extensive lending, all the special facilities that the European Central Bank and all of the central banks embarked on. And I highly endorse these. I voted for them. And I was one of the drivers for embarking on them early on in the crisis, so don't get me wrong.

There is another set of problems that doesn't emerge in liquidity space because deep down it is a solvency issue. And when we talk about some countries in the European periphery, there is a debate, a warranted debate, about sustainability of fiscal positions. When I teach my graduate students in Chicago, I give them a very simple formula for debt sustainability. And that debt sustainability formula basically tells you three things: your growth rate in the long run, your current interest rate funding cost, and basically your level of legacy debt give you an answer on what your primary surplus needs to be to fund that. If a country is bordering on recession and recession becomes deeper and deeper, if interest rates are very high so there is no growth model for the future, and funding costs are huge, a large amount of legacy debt—and there we really talk about anything that is three digits—becomes a problem, and that's when debt sustainability is a issue. And to solve debt-sustainability problems should not involve the central bank. There is a borderline between fiscal space and monetary space, and unless we want to go back to a world that existed before central banks became independent of governments and we're freed of the obligation to contribute to the funding of government debt, we don't want to cross that line. So I hold a very firm, principle-based view on that. I have never had problems with building a bridge to basically bridge a dire situation. That's not the case. But in order to build a bridge, you need two pillars. That bridge cannot lead into nowhere. You need the fiscal authorities to build the other pillar of the bridge, and what I see in Europe is that fiscal pillar of the bridge has, for one-and-a-half years, a sign hanging out there: "Under Construction." And that just won't work.

GUILLERMO ORTIZ: Okay, let's have the last question here, please.

QUESTIONER: *Thank you very much. Let's continue to talk about a euro zone crisis which you want to avoid a little bit. Before the fundamental problems have been addressed, which as you prefer, we have to do something to rescue. That's the reason why the finance ministers and also the central governors gathered together here mainly from BRIC [Brazil, Russia, India, China]*

countries to talk about what they can do to help to rescue. And they declared that they will do something if needed and if necessary. Then the question is what and how. At least four options came to mind. The first is that you can or they can—BRIC countries can give money to the EFSF. And number two, you can inject more money into IMF through a new agreement of the instruments. And third, you can inject capital directly into the banks in the euro zone just as the IMF has stressed for awhile. And finally, maybe you can purchase sovereign debt of the euro zone. It's very dangerous in my mind. So what do you think about all these options? All of them are misleading, or maybe one of them is a little bit of help. Thank you very much.

AXEL WEBER: Well, just to put that right, I didn't say that I wanted to avoid speaking about the euro zone crisis. Whenever I'm summoned that's the only thing I ever get asked. So I was under no illusion to be able to walk away from questions on that. What I wanted to say more is that I'm not a policymaker on the inside of the policy circle anymore, and I do think actually that having made that transition from the policy world to a more private role it warrants actually not to be seen sitting on the fence and giving your former colleagues good advice from the outside all the time. And having a cooling-off period, I try and stick with that advice.

So if you ask me about the question of what should be done—and you mentioned four or five dimensions in which the European fund could be improved—yes, I think we all understand that there needs to be further action, because the action embarked on so far hasn't really convinced the market that we are in a sustainable solution. And all of the elements you mentioned could be either jointly or separately part of the solution.

But again, let me just maybe allude to what my understanding of the role of central banks and maybe ex–central bankers is. We can advise governments on the technicality of choosing those tools, but the European rescue mechanism is a deeply fiscal mechanism. When we advise governments, we basically can warn about incentive policies, moral-hazard problems that emerge from wrong constructions, and the idea of leverage that you mentioned as one of them was an idea that was around the table all the time. The idea about leverage—and that is putting capital into this fund—means that if governments agree, that the money that is in the fund is not just junior only to the IMF and senior to the market. If it's no longer with the market and junior only to the IMF, it becomes a capital element, a first loss tranche, in reinsuring European capital markets. If that's a decision governments take, then I think that is something that is firmly in the set of their responsibilities. But you cannot expect central

banks that have a different remit to go to the point where they suggest to governments, on what is the risk profile of common funding in a rescue program, that they should expose national taxpayers' money to in an international rescue mechanism. Clearly, most bang for the buck you get with a first loss tranche. With a capital thing, you can leverage that fund. And there is a real debate about the need to increase the funding ability, and basically leverage is one of the instruments.

But if you talk about leverage, it should ring a bell. When we discuss leverage in financial institutions, you can make the point that if leverage was part of the problem, leveraging public finances can be part of the solution. Fighting fire with fire—it's well known, but it's a risky thing because what it means is that you expose taxpayers to a much higher probability of losing their entire money on the table if you move them into an adverse risk position relative to the market. And my understanding is once this is theoretically possible and we have all the financial expertise on how to construct such vehicles, the real debate is, will the taxpayers, after having rescued the banking system with billions of euros, accept being put at risk with their funding again to such a degree? So it's a political decision. It firmly belongs in political space. I hold a clear view on what should be done and what should not be done, but I don't really think that governments can circumvent the hard decision to put that in front of their taxpayers and their parliaments, and let parliaments decide whether they want to take this position or not. Ultimately I believe that if market circumstances become much worse than they are now, we will see much more drastic action. We've seen that in the United States. It needed drastic circumstances. It almost needed an institution in failure to warrant drastic action. It's not a first-best solution. It clearly is second-best, bordering onto third-best. But very often in political circumstances, the choice is not between first-best solutions. The choice is very often between second- and third-best. And I feel very much that the situation is going to deteriorate further before it improves.

GUILLERMO ORTIZ: Well, let me again thank Axel for his excellent presentation and his frankness in answering these difficult questions. So please join me and I'll say goodbye to him.

AXEL WEBER: Thank you.

GUILLERMO ORTIZ: Before we adjourn, Kate Langdon, who is the Vice President and Secretary of the Foundation—who really runs everything here—will tell you some logistical things.

KATE LANGDON: Axel's lecture will be available on the Foundation's website shortly if you want to read it in much more detail. There is also coffee at the back of the room. We'd like to thank you for coming out on a Sunday morning to join us here. So thank you very much for coming.

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Axel A. Weber

Axel A. Weber (b. 1957) is the Chairman of UBS. He was president of the Deutsche Bundesbank between 2004 and 2011, during which time he served as a member of the Governing Council of the European Central Bank, a member of the Board of Directors of the Bank for International Settlements, German governor of the International Monetary Fund, a member of the Steering Committees of the European Systemic Risk Board and Financial Stability Board, and a member of the Group of Seven (G-7) and Group of Twenty (G-20) Ministers and Governors. Currently on leave from the University of Cologne, he is a visiting professor at the University of Chicago Booth School of Business. From 2002 to 2004, Mr. Weber served as a member of the German Council of Economic Experts. He was a professor for international economics and Director of the Centre for Financial Research at the University of Cologne from 2001 to 2004, and a professor for monetary economics and Director of the Center for Financial Studies at the University of Frankfurt am Main from 1998 to 2001. Prior to this he taught economic theory at the University of Bonn.

He is a member of the Group of Thirty in Washington, D.C., and a research fellow at the Centre for Economic Policy Research in London and at the Centre for Financial Research in Cologne. Mr. Weber is also a senior research fellow at the Centre for Financial Studies in Frankfurt am Main and a member of the European Money and Finance Forum. In addition, he is a member of the Monetary Economics and International

Economics Councils of the leading association of German-speaking economists, the Verein für Socialpolitik, a member of the advisory board of the German Market Economy Foundation, and a member of the Hochschulrat of the Goethe University in Frankfurt am Main.

Mr. Weber graduated from the University of Siegen with a PhD in economics after receiving a bachelor's degree in economics from the University of Konstanz. He holds honorary doctorate degrees from the University of Duisburg-Essen and Konstanz. Mr. Weber is a German citizen.

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2009 *Growth After the Storm? A Longer-Run Perspective.* Lecture by Kemal Derviş.

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The Approach to Macroeconomic Management: How It Has Evolved. Lecture by Lord George.

2007 *Balance of Payments Imbalances.* Lecture by Alan Greenspan.

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2004 *The U.S. Current Account Deficit and the Global Economy.* Lecture by Lawrence H. Summers.

Some New Directions for Financial Stability? Lecture by C.A.E. Goodhart, CBE (Zurich).

2003 *The Arab World: Performance and Prospects.* Lecture by Abdlatif Yousef Al-Hamad (Dubai).

2002 *The Boom-Bust Capital Spending Cycle in the United States: Lessons Learned.* Lecture by E. Gerald Corrigan.

Recent Emerging Market Crises: What Have We Learned? Lecture by Guillermo Ortiz (Basel).

2001 No lecture took place due to the cancellation of the Annual Meetings of the IMF and the World Bank.

2000 *Ten Years On—Some Lessons from the Transition.* Lecture by Josef Tošovský (Prague).

Strengthening the Resilience of Financial Systems. Symposium panelists: Peter B. Kenen, Arminio Fraga, and Jacques de Larosière (Lucerne).

1999 *The Past and Future of European Integration—A Central Banker's View.* Lecture by Willem F. Duisenberg.

1998 *Managing the International Economy in the Age of Globalization.* Lecture by Peter D. Sutherland.

1997 *Asian Monetary Cooperation.* Lecture by Joseph C.K. Yam, CBE, JP (Hong Kong SAR).

1996 *Financing Development in a World of Private Capital Flows: The Challenge for International Financial Institutions in Working with the Private Sector.* Lecture by Jacques de Larosière.

1995 *Economic Transformation: The Tasks Still Ahead.* Symposium panelists: Jan Svejnar, Oleh Havrylyshyn, and Sergei K. Dubinin.

1994 *Central Banking in Transition.* Lecture by Baron Alexandre Lamfalussy (London).

Capital Flows to Emerging Countries: Are They Sustainable? Lecture by Guillermo de la Dehesa (Madrid).

1993 *Latin America: Economic and Social Transition to the Twenty-First Century.* Lecture by Enrique V. Iglesias.

1992 *A New Monetary Order for Europe.* Lecture by Karl Otto Pöhl.

1991 *The Road to European Monetary Union: Lessons from the Bretton Woods Regime.* Lecture by Alexander K. Swoboda (Basel).

Privatization: Financial Choices and Opportunities. Lecture by Amnuay Viravan (Bangkok).

1990 *The Triumph of Central Banking?* Lecture by Paul A. Volcker.

1989 *Promoting Successful Adjustment: The Experience of Ghana.* Lecture by J.L.S. Abbey.

Economic Restructuring in New Zealand Since 1984. Lecture by David Caygill.

1988 *The International Monetary System: The Next Twenty-Five Years.* Symposium panelists: Sir Kit McMahon, Tommaso Padoa-Schioppa, and C. Fred Bergsten (Basel).

1987 *Interdependence: Vulnerability and Opportunity.* Lecture by Sylvia Ostry.

1986 *The Emergence of Global Finance.* Lecture by Yusuke Kashiwagi.

1985 *Do We Know Where We're Going?* Lecture by Sir Jeremy Morse (Seoul).

1984 *Economic Nationalism and International Interdependence: The Global Costs of National Choices.* Lecture by Peter G. Peterson.

1983 *Developing a New International Monetary System: A Long-Term View.* Lecture by H. Johannes Witteveen.

1982 *Monetary Policy: Finding a Place to Stand.* Lecture by Gerald K. Bouey (Toronto).

1981 *Central Banking with the Benefit of Hindsight.* Lecture by Jelle Zijlstra; commentary by Albert Adomakoh.

1980 *Reflections on the International Monetary System.* Lecture by Guillaume Guindey; commentary by Charles A. Coombs (Basel).

1979 *The Anguish of Central Banking.* Lecture by Arthur F. Burns; commentaries by Milutin Ćirović and Jacques J. Polak (Belgrade).

1978 *The International Capital Market and the International Monetary System.* Lecture by Gabriel Hauge and Erik Hoffmeyer; commentary by Lord Roll of Ipsden.

1977 *The International Monetary System in Operation.* Lectures by Wilfried Guth and Sir Arthur Lewis.

1976 *Why Banks Are Unpopular.* Lecture by Guido Carli; commentary by Milton Gilbert (Basel).

1975 *Emerging Arrangements in International Payments: Public and Private.* Lecture by Alfred Hayes; commentaries by Khodadad Farmanfarmaian, Carlos Massad, and Claudio Segré.

1974 *Steps to International Monetary Order.* Lectures by Conrad J. Oort and Puey Ungphakorn; commentaries by Saburo Okita and William McChesney Martin (Tokyo).

1973 *Inflation and the International Monetary System.* Lecture by Otmar Emminger; commentaries by Adolfo Diz and János Fekete (Basel).

1972 *The Monetary Crisis of 1971: The Lessons to Be Learned.* Lecture by Henry C. Wallich; commentaries by C.J. Morse and I.G. Patel.

1971 *International Capital Movements: Past, Present, Future.* Lecture by Sir Eric Roll; commentaries by Henry H. Fowler and Wilfried Guth.

1970 *Toward a World Central Bank?* Lecture by William McChesney Martin; commentaries by Karl Blessing, Alfredo Machado Gómez, and Harry G. Johnson (Basel).

1969 *The Role of Monetary Gold over the Next Ten Years.* Lecture by Alexandre Lamfalussy; commentaries by Wilfrid Baumgartner, Guido Carli, and L.K. Jha.

1968 *Central Banking and Economic Integration.* Lecture by M.W. Holtrop; commentary by Lord Cromer (Stockholm).

1967 *Economic Development: The Banking Aspects.* Lecture by David Rockefeller; commentaries by Felipe Herrera and Shigeo Horie (Rio de Janeiro).

1966 *The Role of the Central Banker Today.* Lecture by Louis Rasminsky; commentaries by Donato Menichella, Stefano Siglienti, Marcus Wallenberg, and Franz Aschinger (Rome).

1965 *The Balance Between Monetary Policy and Other Instruments of Economic Policy in a Modern Society.* Lectures by C.D. Deshmukh and Robert V. Roosa.

1964 *Economic Growth and Monetary Stability.* Lectures by Maurice Frère and Rodrigo Gómez (Basel).

The Per Jacobsson Lectures are available on the Internet at www.perjacobsson.org, which also contains further information on the Foundation. Copies of the Per Jacobsson Lectures may be acquired without charge from the Secretary. Unless otherwise indicated, the lectures were delivered in Washington, D.C.

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