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Transcript

HAPPY NEW YEAR?
THE WORLD ECONOMY IN 2010

TUESDAY, JANUARY 5, 2010,
10:00 A.M. TO 12:00 P.M.
WASHINGTON, D.C.

WELCOME/MODERATOR:
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PETER BOTTELIER: Good morning all assembled here in this room and to the broader C-SPAN audience. My name is Peter Bottelier. I am teaching courses on China's economy at Johns Hopkins School of Advanced International Studies. I am also a nonresident scholar here at the Carnegie Institute. This is the first seminar of the year, I understand. And the title of the seminar appropriately is Happy New Year? The World Economy in 2010. But there is a question mark behind the Happy New Year. And the meaning of the question mark I assume will become clear in the proceedings during this seminar. The recession that we are struggling to get out of is an unusual recession and that is the reason for the question mark behind the Happy New Year.

We have five panelists who all make it their business to predict the future, at least trends in the future. And they are all heavy hitters in that subject. In order of the seatings here Uri Dadush is the Director of the International Economics program here. Before that he worked for a long time at the World Bank where he was responsible for research and trade policies and for the publication of the very influential World Bank's Global Economic Outlook publication.

Next to him we have Philip Suttle who is the global hat of economic research at the Institute of International Economics here in Washington. He is responsible for developing IMF's economic work, the broad economic views and product development. He is the author of many long and short articles that are published in various ways including on the web.

Next to me on my left is Jorg Decressin who is the head of the World Economic Studies Division in the Research Department of the IMF. He coordinates the IMF's world economic outlook and he has led the IMF's EU policies division and the IMF missions to Israel. He is published widely on capital markets on reform and stability and the European

Growth Pact. He is also the author of a recent book, Integrating Europe's Financial Markets.

On my immediate right is Desmond Lachman, currently with the American Enterprise Institute after he served as Managing Director and Chief Emerging Market Economic Strategist at Salomon Smith Barney. He was also prior to that a Deputy Director in the IMF in the Policy Development and Review Department and he has written extensively on the global economy, the U.S. housing market, the U.S. dollar, strains in the Euro market and his work at the American Enterprise Institute at present is focused on global macroeconomic and global currency issues.

On my far right is Hans Timmer. Hans Timmer is Director of the World Bank's Development Prospects group. Under his management the group produces the World Bank's annual publications, global economic prospects, global development finance and global monitoring report. In addition there is a wide range of forecasting publications that come out of the World Bank under his supervision

So you see we have a panel of heavy hitters on the subject matter for this seminar. The procedure for this seminar is slightly different than normal. There will be no sort of lengthy presentations with slides, which is customary. Instead, I will ask five different questions. And I will ask - three of the panelists will answer each of the questions. And they have three minutes per question. They don't know ahead of time which questions I will ask them. That is deliberate in order to create an atmosphere of real discussion and to make this seminar different from the conventional presentation seminars. After that we will have an opportunity for discussion with the audience and questions that may come in from a larger audience

So I will now ask the first question and ask three panelists to address that question three minutes each. The first question is as announced in the program for this program: Why did 2009 turn out to be better than expected?

And the persons whom I will address the questions are Hans Timmer, Uri Dadush and Jorg Decressin. Hans, would you start with the first question? Why did 2009 turn out to be better? Please try to limit your reply to three minutes.

HANS TIMMER: And the first question is, "Was, actually, 2009 better than we expected?" And I won't go back to all the forecasts that we all did before, but let me start with the observation that 2009, of course, was not a good year. It was one of the greatest recessions that we have ever experienced. And it is true that we have avoided larger disasters. But if you look at the current situation even after many economies are coming out of the recession, production levels across the world are still some 7 to 10 percent below what they were before the crisis. Unemployment in many countries is around 10 percent. There are huge problems emerging for the governments and their fiscal positions.

The positive growths that we are seeing at the moment are to a large extent driven by temporary factors. By all means this was not a good year even if growth was very positive. If you look at the forecast, and I cannot talk in detail about our forecast because we will publish them later in this month, on January 21, you will see that the kind of recovery that we are all talking about is relatively muted given the size of the decline that we have seen. And then probably later in the discussion we will talk about the major risks that are still out there. So going back to the question, "why was 2009 much better" I would answer with the observation that actually 2009 was a year that has created huge problems and that it will take several years to solve those problems.

PETER BOTTELIER: Thank you, Hans. The next panelist that will address this question is Uri Dadush.

URI DADUSH: Thank you, Peter. Well, first of all I agree with Hans that 2009, of course, was an awful year. At the same time if you reel back to, say, 6 to 8 months ago we were at that time considering the possibility of a fall into depression. The picture now looks remarkably different. We have just finished a quarter, the third quarter. We don't have full data for the fourth quarter yet where world to aid and industrial production is on a sharp recovery path, one of the fastest growth rates recorded.

And so one point before I say what actually explains this better than forecast outcome, let me say that there is a marked difference in the acceleration of developing in industrial countries. If you look at the consensus forecasts that were made in the middle of 2009 the industrial countries, the advanced countries by and large are doing better but only a little bit better than anticipated back 6 months ago. On the other hand, in the emerging markets, particularly I'm referring to China, India, Brazil as the largest, but several others, the acceleration has been very significant and the numbers are some 2 percent stronger estimated now for 2009 than they were in the middle of the year.

What are the reasons? Four reasons I will mention very briefly that we are doing better than we thought. First of all, the policy measures that were taken were unprecedented, the financial rescue, the fiscal stimulus, and the monetary stimulus have virtually no precedent. Maybe fiscal stimulus you can call some precedence. So the aggressiveness of the policy response was extraordinary.

The second reason is that these policies, by and large, worked. Not a foregone conclusion. Many of these policies were very controversial. But if you look at the numbers, if you look at the spreads, etc., etc., any number of indicators, you have to say that we are in enormously better shape than we were 9 months ago.

The third factor I will mention is the fundamental strength of Asia going into this recession and the fact that they were able to respond very aggressively. A lot of it had to do with policy in Asia, as well. But basically the banking sector and the household sector and the corporate sector in Asia was just in very good shape and has been able to provide a major source of support for the world.

And the fourth and last factor that I will mention is that the world avoided the worst contagion effects. What am I referring to? I am referring to financial contagion. We avoided a series of massive sovereign debt crises, at least so far. IMF played a very important role and various other things happened. But the crisis in the past greatly exacerbated the problem during the Great Depression, during the Asian Financial Crisis. And we avoided under the contagion heading a surge of protectionism. We have had quite a bit of protectionism, but it has not become a generalized phenomenon as it did in the 1930s.

PETER BOTTELIER: Thank you, Uri. Last person addressing the first question is Jorg Decressin.

JORG DECRESSIN: Thank you. Let me first explain to you what we did originally expect what was going to happen. And if you go back to about one year ago, so talking about January, 2009, we forecast that the advanced economies would be moving out of recession sometime in the middle of 2010. What has actually happened is quite different. If you look at the advanced economies as a group they posted growth rates of about 2 percent in the third quarter of 2009 already. So this recovery is off to a start that is a good deal earlier than the start that we had expected one year ago.

At the same time, traditionally it used to be said that if the U.S. catches a cold then our emerging economies catch the flu. This time around it has been quite different. There have been emerging economies that have been badly affected by this crisis but many others have actually been remarkably resilient. And in these economies, for example, now in the second quarter of 2009 and the third quarter of 2009 you observe growth rates of around 8 percent in them as a group. Of course, there are big differences between the Asian economies and the American economies on the one hand and then some Eastern European economies and economies of the Commonwealth of Independent States. But on the whole it's a picture that is a good deal better than what we had expected one year ago.

Now, why is that the case? Uri has already alluded to some of the reasons. If you go back a year what we all certainly did was underestimate the depth of the contraction of the global economy that then materialized in the fourth quarter of 2008 and the first quarter of 2009. We were all puzzled by the deep fall. And we attributed it to basically the fear of global depression. So two confidence factors. So it is always very hard to gauge these confidence factors correctly.

What are we seeing right now? Well, we have had a very strong policy response to this fear of depression and the turmoil in the markets. Exceptional monetary measures with interest rates cut close to 0 in many advanced economies with unconventional support for banks being made available. We have seen fiscal stimulus deployed across advanced and emerging economies. And then we've also seen recapitalization of banks and guarantees for banks in order to get the financial sector running again.

And what has all of this done? Well, it has changed the fundamentals on the ground but it has also changed confidence. And, again, it's very difficult to forecast confidence. And the rebound in confidence has certainly been stronger than what we had expected. And so that's why this recovery is off to a better start than what we had expected one year ago.

PETER BOTTELIER: Thank you. We are doing well on time. The second question I will put to three panelists is: Do you expect the recovery to continue in 2010? And if so do you expect it to be L-shaped, U-shaped or V-shaped?

The first person to whom I would like to address the question is Desmond Lachman.

DESMOND LACHMAN: Thank you, Peter. I am just noticing that in the question you left out letters like W and square root signs. Leaving aside that comment, I am very much in the camp of people like Janet [INAUDIBLE], Paul Krugman, Marty Feldstein expecting the recovery to be extremely subdued. And I can be talking about this both at the U.S. level and at the global level. I would be rather concerned in policy making circles if I saw with the massive stimulus that we have had, for instance in the U.S. economy, fiscal stimulus that's unprecedented, monetary -- that we haven't managed to register something like 2.2 percent growth in the third quarter of the year.

So the big question arises: What happens when the fiscal stimulus fades as the fiscal stimulus certainly will fade in the second half of 2010? And there is a real risk that we do get a double dip recession as that fades. Now, the reason I say that is that there are extraordinarily strong headwinds against U.S. economic recovery right now. The most notable of those headwinds is the situation in the labor market. Not only do we have 10 percentage points of Americans out of work, but if you include those who are working part time on an involuntary basis and those discouraged, if you look at the labor department's U-6 measure of unemployment, we are at something like 17 and a half percent. So the issue is that that kind of labor market is going to be exerting very strong downward pressure on wage growth, on income growth. And without that kind of income growth there is just no possibility of getting a meaningful recovery on consumption.

In addition, what Federal Reserve officials keep alluding to is that we are on the cusp of another big downturn in the commercial property market which could cause real problems in the regional banks. We've got a wave of foreclosures that is still going to be hitting the residential property market. So we could get declines in housing that continues. And in addition you've got a banking system that is still dysfunctional. What we notice is despite The Feds reducing interest rates the way they've done pumping liquidity into the system we've really got the banks cutting back on credit especially to consumers and to small and medium sized enterprises.

So I just don't see the basis for a strong recovery in the United States. I think that a V-shaped recovery is wishful thinking. We will see what happens in the second half.

What I'm really worried about, though, is the situation in Europe. What we've got now in Europe is real tensions emerging in the Eurozone. And I'm not just referring to Greece but I'm referring to Portugal, Spain and Ireland. All of those countries have really got trouble staying within the Eurozone. They are going into big downturns. They've got double digit deficits, both on the budget and on the current account that is really going to be a huge drag for the global economy. I wouldn't exclude the possibility that we have a real full blown crisis in either Greece, Spain or Ireland in the year ahead.

Finally, let me just say a word on Japan. Japan makes the United States budget situation look very prudent, well managed budget. They've got a debt that is now moving towards 200 percent of GDP. And Japan is, again, fighting with deflation. So don't expect Japan to be pulling us out of the situation.

So in short I'm in the camp of an L-shaped recovery at best with the real risk, maybe a 50 percent risk, that we get a double dip in the second half of 2010.

PETER BOTTELIER: Thank you, Desmond. My next panelist on this question, "Will the recovery continue? And if so what shape will it be" will be Philip Suttle.

PHILIP SUTTLE: Well, I always get confused when people ask shapes of recovery because it's kind of like a draw in the dot exercise. And I'm never quite sure if we're talking about growth rates or levels. But bottom line here is if you look at our forecast and, I think, frankly, most forecasts these days, we're already seeing a V in the sense that we had modest growth in 2007 and 2008; very negative, as we heard earlier, very negative global growth in 2009; and somewhat already predetermined by the dynamic that we have going into the year the very strong likelihood of a return to moderate global growth in 2010.

And I think what's kind of interesting these days about the global outlook discussion is really most discussion isn't really the issue about what comes next. We sort of take it for granted. I think most of us would take it for granted that the global economy is going to grow something like 2 and a half percent this year. It's really what comes after that in 2011 and beyond that's the key issue.

And Desmond raised a whole series of issues that I'm sure we're going to come back to in the next half an hour or hour or so that really I think drive much of the medium term outlook.

But coming back to the 2010 issue. I think I probably position myself certainly relative to number and the rest of the panel as a relative optimist here. And I think I would highlight four aspects of the outlook that are really quite important that tend to not be the focus of the current time. Somewhat unfortunately our industry tends to be very extrapolative. And when things are going well we tend to assume they are going to continue to go well. When things are going very poorly we tend to cite those factors as reasons for things to continue to go poorly. And I'm not so sure that's the right way to think about the world.

But I would highlight four factors that I think dominate 2010. First is the synchronized nature of the upturn. We had a synchronized downturn, very powerful in the fourth quarter of '08 and the first quarter of '09. We have now seen a synchronized upturn that's about 6 months already in duration. And it will continue for at least another 6 months. And it will feed on itself as most globally synchronized processes do.

Second feature here is - and it's a point that I think is very important. Uri raised it somewhat but I think we should keep coming back to it. It's the growing role of the emerging markets in leading the expansion. And it isn't just Asia. It's Latin America and it's parts of - it isn't just East Asia. It's parts of South Asia as well as Latin America. And even in emerging Europe, Eastern Europe, there are some stronger economies that are beginning to show some signs of vigor such as Poland.

Third factor is - and this is, I think, the big unknown to an extent, but I think a very important point not to lose sight of - is the turnaround that's liable to occur in the corporate sector. I mean, one way of thinking about this downturn of 2009 is we had corporates adjusting very aggressively and in so doing turn their financial position from one of modest net borrowing to one of substantial financial surplus. Now, maybe that financial surplus position will remain for the next 6 months or 9 months but my suspicion is that it will increasingly turn into a little more corporate activity and corporate optimism, whether it is on the capital spending side or the employment side.

And that takes me to my fourth and final point here which is that I think we are going to get a turn in the global employment picture. I mean, Desmond used the high level of unemployment in the U.S. and the weak labor market as a reason for extended weakness. I would actually turn that point a little bit on its head and say that as the economy picks up what we're going to see here is a turn in labor market conditions. I think we are already seeing it in some of the high frequency indicators. And I think it is going to actually become a global phenomenon. And what we're seeing in some of the hiring surveys that we look at is the global employment picture potentially looking much better by the time that we get to the middle of the current year. That's not the same thing as saying, of course, that unemployment will go away. We are going to be stuck with high unemployment levels and low employment levels for an extended period. But the delta on those variables in terms of where they are going does seem to be - we seem to be pretty much close to an inflection.

PETER BOTTELIER: You've heard two very contrasting views on near term prospects. I'm curious, Uri, what are your views on the question whether the recovery will continue and if so what shape it will take?

URI DADUSH: My view is that, of course, the recovery, I believe, will continue certainly in the course of 2010. And I am much closer to Phil, probably a little more optimistic than Phil than I am to Desmond. And let me point to my four factors for saying that we have in the advanced economies, at least, a U-shaped recovery, not necessarily a very sharp V-shaped recovery. But quite easily half a percent or so faster than consensus which in this country, for example, is I think 2.7 percent or 2.5 percent depending on what you look at for 2010.

My four factors overlap to a degree with Phil's but the first one is that the push by the emerging markets -- I think that we simply have to underscore the fact that a large part of the world and this is a part of the world which is on a very rapid long term growth path did not have a massive banking crisis, does not have a financial crisis of the classical type. They suffered a very large external shock, but by and large their financial sectors remained whole. And if you look at the three largest emerging economies, China, India and Brazil, they are basically somewhere near their long term growth path. And even in 2009 they are a little bit below their long term growth path but not much. So the underlying momentum in that part of the world is very, very strongly being driven by domestic demand, of course, almost by definition, less by exports.

The second factor that overlaps with Phil is that I am very impressed by the speed at which the non financial corporate sector has reacted here in the United States. And there's a lot of evidence that employment has been cut very rapidly and more significantly than in some sense warranted by demand. And so has investment and so has inventories, etc. And this is reflected in much better than expected earnings of non financial corporate - by the way, not just in the United States but in Europe, as well, in the course of 2009 -- and a strong financial position. This suggests to me that along with many others I expect a turn in the employment picture, especially given the latest numbers coming from the PMIs that suggest that we are still on a strong expansion path.

The other two factors that I will point to which go beyond or are different than Phil's are in the order of importance I would say policies remain supportive in 2010. A large part of the stimulus packages is still to be spent according to the OMB. I think it's only about a third of the stimulus money has been spent in this country. And financial support to the banking system remains. I am actually encouraged by the fact that the largest banks in the United States and in Europe are repaying the government. Unless you are convinced that the new boards and the new CEOs of these banks are suicidal you have to assume that they are looking at their businesses and the fact that they are repaying the government is, I think, good news.

The third and most important factor in policy is I believe that the power of monetary policy is increasing, has increased very significantly in the last 6 months. A year ago you could argue we were in a liquidity trap, that lowering policy interest rates didn't matter very much because risk aversion was so extreme that people just accumulated cash. Well, all indicators of risk aversion have come down big time. So the very low, historically low policy interest rates are having now a very important but positive impact on economic activity. And so will be in the foreseeable future in 2010.

And finally just to mention it briefly because the point is often made. We are coming off of a situation where all deferrable expenditures were deferred. We deferred capital expenditures. We deferred cars. We deferred houses. We deferred the buildup of inventories. And all you need is for some improvement in those deferrable items compared to the large declines that occurred in 2009 for you to see significantly rapid growth in 2010.

PETER BOTTELIER: Thank you, Uri. My next question deals with something that various panelists have already commented on. And that is the difference in performance, recovery performance between the established industrialized countries, the older industrial countries and the emerging economies. My question really is: How do we explain that? And what is the outlook for the near term future for these two major groups, the emerging economies and the older established industrialized economies? The first person to whom I would like to put that question is Hans Timmer.

HANS TIMMER: Thank you very much. Phil said that the recovery is very synchronized in nature and that, of course, is true. We were talking about global downturn and also a global recovery. The fact that it is synchronized has a lot to do with the functioning of the financial markets. But given that fact it is very interesting to see that there are major differences between the emerging economies and the rich economies and that there are major differences within the developing world, within the emerging economies.

Half a year ago in a panel here I made two points. One was that the recovery will be relatively muted given the size of the fall in production that we had experienced. And the second observation was that the strength will depend on the emerging economies because emerging economies had become the driver of growth in the world economy. It's especially true for emerging Asia. If you look at their contribution to growth, not the size of the economies, that is still only 20 or 25 percent of the world economy, but their contribution to growth was more than 50 percent during the boom period before the crisis. But much more important their contribution to growth and investment is significantly larger than the contribution of the high income countries' growth to investment. And this was a crisis that really was characterized by sharp movement in investments; huge fall in the recovery has to come from investment also.

That is what you are seeing now happening. The recovery is driven by the turn up in production in emerging Asia to a large extent because of the stimulus in China. If you look at their import growth, that is probably faster in history in recent months, much faster than their export growth. It pulls the region out of the recession also. Their production levels are now higher than it was before the crisis while in the high income countries industrial production is still 12.5 percent below what it was before the crisis.

So we see despite the fact that it is synchronized a big difference between the emerging economies that are really leading the recovery and the high income countries that are more following. But then within the emerging economies there is a major differentiation. The kind of recovery that we are seeing in Asia is not there in central Europe and Eastern Europe despite the fact that indeed Poland shows relatively solid performance.

But there are still many countries where the recovery is hardly there. Basically what you are seeing there is that the drop in production has stopped but no clear signs of recovery. The picture in Latin America is very diverse. Strong recovery in Brazil, but there the fall in production was also very strong. But in a country that had very sound policies like Chile we are not seeing the recovery yet.

And then what we are very concerned about is the low income countries. They were actually not that much impacted by the crisis in terms of a fall in production. They were much more impacted in terms of a fall in income because of the fall in commodity prices. And our expectation is that the impact of the crisis is much more in the medium run for those low income countries and not so much in the short run. In the medium run because they don't have the fiscal space to respond to the events. And many of the mechanisms that are important in low income countries actually come with a lack in terms of the dynamics of poverty, the dynamics of the fiscal conditions in those countries. So a very diverse picture but what is very positive is that emerging Asia, especially, is playing the leading role that was forecast, also.

PETER BOTTELIER: Thank you. Not just emerging Asia, but several other large emerging economies are also doing better. But my next panelist on this question is Desmond Lachman. Desmond, what explains this remarkable difference in performance between the larger emerging economies in 2009 and the established industrialized economy? And what lies ahead in the near term future?

DESMOND LACHMAN: Before I address that I would just like to go back to some of the points that have been raised earlier. I think something that is being missed is the very different nature of this recession and one of the features of this recession is the damage that is done to the banking system that IMF estimates suggest that we've still got very much of the loan losses that have to be recognized. We've got a banking sector certainly in the United States and in Europe that is not lending, that they are, in fact, cutting down on credit. So despite what The Fed is doing we've got a reduction in credit to particularly consumers and smaller enterprises.

Research done by Rogoff and Reinhart in *The 800 Years of Financial Folly* suggest that when you do have major financial crises of this sort your recoveries tend to be very shallow and really have risks of having another letdown.

Another point that I would want to make is just on the employment situation. Certainly you are not going to get unemployment continuing to rise. But what we will have in 2010 is economies like the United States being characterized by unemployment at a rate that is close to 10 percent or double what economists would regard as the full employment rate. As long as that exists you have downward pressure on incomes and that will make it very difficult for a recovery to go.

As to the question on the emerging markets, I agree that the fundamentals of a lot of these emerging markets are a lot better than those in the industrialized countries. And I say most notably what you see is pretty much better public finances in the emerging markets. The deficits are a lot smaller and the levels of debt are something like half those in the industrialized countries. Where in the industrialized countries are heading towards 100 percent of GDP the emerging markets have got deficits closer to 50 percent of GDP. So I think that what you have seen is you have seen that the emerging markets certainly in Asia, certainly in Latin America, they have learned from past crises that it's better to have their finances in good shape so they weather a recession like this rather well.

Emerging markets right now are benefiting from a couple of factors that I'm not sure will persist in 2010 if my call is correct that you're not going to get much of a global recovery. The first is that commodity prices have boomed in a way that we haven't seen in the post war period. So many of the quantity exporters are benefiting from that. What they are also benefiting from is that risk taking has come back on the expectation that you are not going to be getting a V-shaped recovery. If you don't get the V-shaped recovery and you get risk aversion returning, as I expect you'll get, you'll then begin to see problems reemerging in places like Eastern Europe where the Baltic countries, just to mention one area which just looks like it is heading towards a full blown crisis, but you'll also get Ukraine, Hungary, Bulgaria, Romania, the eastern periphery of Europe is likely to be in trouble.

Just one last word just on the situation in China. China has surprised us in a very positive way by its very rapid growth in 2009. And that was really achieved through massive fiscal stimulus policy, massive easing of monetary policy. But the question that I've got is whether in 2010 we are not going to see problems emerging in the global economy from the Chinese situation. And what I'm referring to is much of the stimulus package went to building up additional excess capacity which is going to come on stream in 2010 at a time that Europe and the United States are going to be having very high unemployment levels. I'm not sure that that is going to be a very positive development for the world economy. What we are going to see is heightened protection as pressures which you've already got right now. And if China is going to be providing additional supply that's really going to make life rather difficult for the U.S. and Europe.

PETER BOTTELIER: Thank you. My final panelist on this question: What is the explanation for the different performance between the large emerging economies especially in Asia and the oldest industrialized economies? And what lies ahead? Jorg Decressin.

JORG DECRESSIN: Let me talk a little bit first about similarities and then go about talking about differences and give you some explanations. Now, on similarities, if you look at growth rates in advanced economies in 2007 there were somewhere around 3 percent. And in 2009 they were at minus 3 percent or somewhat more than that. So you had a 6 percentage point reversal in growth.

You look at what happened in emerging economies in 2007 their growth rates were around 8 percent. And in 2009 they are around 2 percent. So also a 6 percentage point reversal. So there is a similarity here. We are - the advancing and emerging economies, they are cyclically connected. But then again I much rather have 2 percent growth like emerging economies have now than more than minus 3 percent growth which is what the advanced economies have.

So this leads me to the second part, the dissimilarity. And this is that fundamentally the structural growth prospects of the emerging economies are a good deal stronger than those of the advanced economies. In fact, if you look at what happened to the emerging economies during this global downturn they did a good deal better than they did during previous global downturns.

Now, why is that the case? What's going on here? Well, many of these emerging economies are tapping production potential that has just remained bottled up for many years beforehand. And they are tapping it via market friendly reforms. The second is they have learned from past mistakes and therefore have typically had a very conservative approach to a regulation of the financial sectors and therefore the financial sectors have held up quite well. And the third aspect is that in terms of market policies, too, they have had a fairly conservative approach. As a group the emerging economies went into this downturn with broadly balanced budgets. And thus they had plenty of ammunition to practice countercyclical policy this time around which they didn't have during previous cyclical downturns.

So you put all of these things together and they make for a performance that is fundamentally stronger than that of the advanced economies. And this is also in many ways the way it should be. In economics typically what you observe is if you observe history over long periods and poorer economies, relatively poorer economies grow faster than relatively richer economies for as long as the right conditions are in place for growth to take off. And this is very much what has happened over the past decade.

That said, there is a good deal of -- among the emerging economies. You've got Asia in the lead and Latin America. And then the picture becomes a little more mixed in the Eastern European economies and to the Commonwealth of Independent States. But even in these economies you have examples that are fairly successful such as Poland as Phil had mentioned.

Now, you contrast this with where we are in the advanced economies, as Desmond already pointed out, we are looking at very high or rising unemployment rates for much of this year. And this will weigh heavily on growth. So this will be in our view a recovery that for these economies that is a good deal slower than the recoveries we have observed from previous globally synchronized downturns such as in the mid 70s and early 80s and early 90s.

And so what is the repercussion of this difference in the outlooks between the advancing and emerging economies? You see capital increasingly again knocking on the doors of emerging economies, looking for investment opportunities because the growth fundamentals are stronger, the yields are higher and in many ways the market policies have been quite prudent.

PETER BOTTELIER: Thank you. The third question I would like the panelists to address even though you may have already hinted at it or spoken about it explicitly is: What are really the major risks that you see? And what degree of confidence, therefore, do you have in your expectations? The first person I would like to address that question is Uri Dadush.

URI DADUSH: Peter, thank you. First of all, there are downside risks to this forecast. There are also to the - let's take the consensus as a reference. There are both upside risks and downside risks. I wanted to stress that to start with. It isn't just about downside risks.

The second point I want to make is that the gamut of possible outcomes is in my view a lot narrower than it was 6 to 9 months ago essentially because the likelihood of relapsing to major recession and depression is much lower than it was 6 to 9 months ago.

The upside risks first and then the downside risks. The upside risks really relate to what Phil said about synchronized recovery. And we have a long history of forecasting, of examination of forecasting track records that suggests that there's a lot of inertia in economic forecasting so that we miss turning points so that when things are going up we tend to underestimate the speed at which they go up. And when things are going down as they did until recently, we tend to underestimate the speed at which they go down.

And we are clearly in a turning point kind of situation and it is a synchronized recovery around the world which carries, therefore, the upside risks of strong synergistic effects. The implication of this is that you want to worry about the inflationary pressures building up. You want to worry about the asset bubbles building up. Again, this is a very, very country by country type of situation. It is very difficult to generalize on those. But I did want to underscore the upside risks.

Downside risks to the forecast are primarily coming from economic policy. And here I would highlight two aspects. One is the withdrawal of stimulus and how that is going to happen and whether the private sector will be by then strong enough to support the economy going forward. And the other is protectionism.

Just very briefly, on the withdrawal of stimulus I think the risks coming from the fiscal side are relatively modest. First of all, the effect in the advanced countries hasn't been that large. And second this is a very sticky policy lever. It is not going to turn in a dime.

I also think that the way that the withdrawal of financial rescue is happening is minimizing risks in the sense that it is responding to market situations. It is allowing the banks to come forward and say we don't need all the help. And I think that that is the right way to do it. So I think that the risks there are relatively limited.

Where the risks are much more significant is in the expected and inevitable increase in policy interest rates and withdrawal of monetary stimulus. Because, again, here history teaches that when you are in that situation inevitably you are going to uncover weaknesses. And we are in a position where the world economy continues to be fragile. And so those weaknesses, whether it is Dubai or whatever, are out there and they will be uncovered as policy interest rates rise. So the way that is done, I think, is very, very critical. That's a downside risk.

A word about protectionism. So far we have kept it under control. I am becoming more and more worried about the China/U.S. relationship, this tit and tat, most recently steel. Before it was tires. And the Chinese have done their share, as well. And here that situation I think bears careful watching. I could say a lot more about that but I'll stop there.

PETER BOTTELIER: Thank you, Uri. The next panelist who will address this question, "what are the risks" is Philip Suttle of The Institute of International Finance. Philip, in your earlier comments you have tended to emphasize the more hopeful, more optimistic aspects of the situation. What do you see as the risks?

PHILIP SUTTLE: One issue that I think is important to get one's mind around is the issue of timing of all of this. I mean, one thing I think is that in the near term there are probably more upside risks than downside risks even to the consensus forecast. And a lot of that is things that Uri and myself have been talking about whether it is synchronization or policy traction, inventory cycles. As you look further out I think it's easier to see downside risks. So I don't think it's an absolute thing that's time independent. I think the risk discussion is very much a function of the time horizon that one is focused on.

And I suppose if I can sort of have my cake and eat it a little bit here I'm emphasizing near term strength but medium term vulnerabilities. And if I can focus my risk discussions on those sort of medium term vulnerabilities, let's call it second half of 2010, I mean, I think I would highlight four, some of which have been touched on but it seems like four is the magic number. Let me run through them quickly. By the way, I would like to say hi to all of our viewers in Poland who we seem to be pandering to at the moment.

The first is, and no one has actually mentioned this so I will, oil. If you think about what gives you a global recession oil is five for five including, frankly, 2008, 2009 it so happens that oil and Lehman came together so it is almost impossible to distinguish between the two. But if we have seen oil prices move back above $80 a barrel then if they go to $100 or above, if, not saying that is going to happen, but if it does happen that would be something I think would add significant medium term downside risks.

Second, the fiscal issue which we can talk about all day. Don't worry, we won't. I think the issue that I haven't heard anyone latch onto is the sort of unimaginable. We should all with respect to people like Desmond who call the '08 crisis very well, we should all be prepared to imagine the unimaginable. And what I'm talking about here is not turmoil in the Greek debt market or even the Spanish debt market, but turmoil in the U.S. treasury market because U.S. debt issue is perceived to become so high that it raises concerns. And one important thing to keep your eye on there is what the rating agencies do and say. At the moment they seem to be sticking their head down and trying to avoid attention, but at some point they are going to have to recognize that many of the debt dynamics, not in the smaller OECD countries, but in the major OECD countries are not sustainable with AAA debt ratings.

The third downside risk which kind of is a variance on that is this whole tension in the Eurozone. And I think the concerns I have about tension in the Eurozone aren't just about budget deficits in one or two small countries, it's about the tough ride that we've got in that region in a period where we basically are trying to implement to maintain a fixed exchange rate system in a tough period. And fixed exchange rate systems, as we know, are dead easy to maintain in bullish credit environments. Take the first 7 or 8 years of convertibility in Argentina. But when the credit environment becomes tough and stayed tough and unemployment rates go up and are different between regions within the monetary zone, that's when your rough ride comes. And I think that's very much the challenge that Europe faces, not just for the next few quarters or the next couple of years, but I think for the next four or five years.

And then final issue which you might expect me to raise given that I'm working for an organization sponsored by the banks, is the issue of the banking sector. Now, Desmond raised that point earlier in the context of the damage done to the banks. But the thing that worries me more, actually, is that the fix is being proposed to kind of stop another crisis. While in many ways legitimate as medium term objectives, if they are posed too early -- and that's quite plausible given the political imperative to do something -- if they are imposed too early it would actually act as a severe constrain on the ability of the banking and financial system to finance a recovery. And if we get aggressive actions taken to curtail bank activity, that will come with a significant cost to the economy in the near term.

PETER BOTTELIER: Thank you, Philip. My last panelist on this question, the risks, is Desmond Lachman. And Desmond, I'm going to slightly rephrase the question since most of your comments have emphasized the risks already. Are there any upsides that you can see?

DESMOND LACHMAN: There are two upsides that I can think of, one of which I think is possible is that you get a sharp decline in commodity prices in especially oil, that that could really be helpful. That would be equivalent to a tax cut for the industrialized countries. That could be helpful.

The other upside risk that I could think of is that policymakers miraculously get their act together and engage in proper coordinated policy response. And I think that talk of early withdrawal from stimulus package, that I see as a downside risk. The upside risk I would see is if we really started talking about a second stimulus package in the United States that was coupled -- and I stress this point-- that was coupled with an indication of how we are going to deal with the United States medium term budget problems that we are going to see the largest peace time buildup in the United States public debt. How we are going to address that, I think that is critical.

When I was talking about an L-shaped recovery I wasn't really focusing on the risks, the downside risks that I see. And I would say that the four downside risks that - some of them have been mentioned - that I think have got a very good chance, all too good of a chance of materializing in 2010. In the middle of 2010 is the short term. I do know Philip seems to think that that's the long term. The long term is beyond 2010.

But the four risks that I would indicate. And I put them in the order in which I really think I worry about them. The first is the situation in Europe. Philip correctly mentioned parallels with the Argentina Convertibility Plan. These countries really have to be dealing with a bunch of deficits that are in double digit -- current account deficits that are double digits in the middle of a recession without having an exchange rate mechanism or an independent monetary policy to deal with it. That is a risk. I think that that is a train wreck waiting to happen. And the noises that we are getting about Greece really should be a canary in a coal mine as far as Ireland. Spain is the key one that I'm worried about, and Portugal. So I think that you could really get a full blown crisis in the Eurozone.

The second was also referred to, oil. I would just note in passing -- I don't want to delve into politics, but the United States is fighting two major wars in the Middle East and Iran is on its way to nuclear weapons. So who knows what could happen in the Middle East? You could get a supply disruption. I totally agree at full that that would really be the death nail for the global economy.

The third risk that I see which is very real and which I notice the Federal Reserve officials keep talking about is what's happening in the commercial real estate market. You've got 500 billion dollars of commercial real estate loans coming due in 2010. If those loans don't roll, as many of those won't, we are going to get another letdown in the commercial real estate market. And that's going to have a real damaging impact on the regional banks of the United States. Regional banks, half of their portfolio is in commercial real estate. So the last thing we need is to get a credit crunch in the regional banks which are the suppliers of credit to the smaller and medium enterprises which, in turn, provide most of the growth in employment. So that is a real risk.

The fourth risk to which Uri has alluded is the idea of protectionism. 2010 is an election year in the United States. China somehow persists in fixing its exchange rate now to a depreciating dollar which really is just a red flag and an invitation to have protectionist picture ramping up. And if we have learned anything from the Great Depression that is not very healthy for the prospects of getting out of the mess that we are currently in.

PETER BOTTELIER: Thank you, Desmond. We are running slightly over time. So I'm going to ask the three respondents to my last question to really discipline themselves. Imagine yourself in a meeting where you have a chance to address the G20 for three minutes. And the question is: What should be done other than perhaps what is already being done to promote the recovery chances in the world and in the major economies? If you wish to select any particular country or group of countries for your recommendations you are free to do so. The first panelist I will ask to address that question is Jorg Decressin.

JORG DECRESSIN: What are the fundamental policy challenges we face? We can perhaps distill them down to three. The first is to engineer a shift in demand from public sources to private sources. The second is to engineer a shift in demand from countries that have had large increases in asset prices and housing booms and have had very much relied on domestic demand to stimulate their growth to countries that have mostly relied on exports in order to stimulate their growth. So we need to have a shift there from, say, demand in the U.S. to more demand in emerging and other economies, to give an example.

And the third challenge is that we need to repair the financial systems in many advanced economies and at the same time also effect changes on the supply side of these economies. Obviously, real estate and financial services will be less important drivers of growth in the future and the resources that are being freed from these sectors will need to be employed gainfully elsewhere. So these are the three challenges.

Now, given where we are right now, what would we recommend that policymakers do? Well, first fiscal policy in our view needs to stay accommodative because at this stage private demand is not yet strong enough to carry this recovery forward. And there are, as some of us have alluded, risks building up in sovereign and debt markets and they bear watching it.

And what does this mean for the strategy that governments should adopt to affect the fiscal policy? Well, it means that we need to stay supportive now, but at the same time address medium and longer run challenges.

How can this be done? I will give you a concrete example. If in advanced economies you were suddenly to link statutory retirement ages to life expectancy, this exists in some economies but by far not in all economies. In many economies it would do a whole lot in terms of re-addressing future fiscal imbalances, of reducing expenditures in the future and therefore it would give markets a reassurance that the expansion that we are seeing right now in fiscal policy is going to be contained, that the debt that we are building up right now is going to be rolled back. But at the same time this type of measure would not depress demand today. So it would still help governments support the private sector. But there are other examples of such policies. The bottom line is we need to deal with the medium and longer run challenges.

Second, with respect to monetary policy, again, in advanced economies unemployment is going to be either high or rising in 2010 so there is ample scope for staying accommodative which is what most banks are doing right now.

The third challenge is to deal with the financial sector. And this is a trickier challenge. There is good news if banks are paying back what governments have lent to them. But what we are really concerned about is that they rebuilt their capital and that they restart lending. So these are the two things that we need to monitor. Now, progress is being made in that respect, but at this stage there is still more to be done for the banking sector to be a strong supporter of growth in the future. I mean, if more is not done then one can see this economy running into a bottleneck as credit demand picks up again.

So I think these are the challenges that policymakers face. Now, then there is the other aspect which is we need to shift demand from countries like the U.S. because savings are rising in these countries where consumption is being cut back, to demand in other countries where savings have been high and savings need to be brought down. And that concerns a number of emerging economies. And what we are looking for there are measures to basically boost consumption coming through, for example, reforms to social and safety nets, but there are a whole range of other measures that one can consider such as developing non tradable sectors in these economies.

So it's a complex agenda. Progress is being made. And the G20 in that regard is major good news for those that are very much supportive of coordinating global policies.

PETER BOTTELIER: Thank you. Next, Hans Timmer of the World Bank. You have the audience G20 for three minutes.

HANS TIMMER: Thank you very much. I think the biggest challenge for policymakers including those of the G20 is to transition from short term firefighting as if there is no tomorrow to medium and long term growth strategies. That doesn't mean that firefighting is not important because you can prevent having your house burned down. It doesn't also mean that prematurely you should stop extinguishing the fire. But with the turnaround of the global economy at the moment with the fact that the acute phase of the crisis is over we really have to focus to that medium term because with firefighting you are not developing new terms.

There are three reasons, I think, why that transition is so important. The first one is that there are serious limits to short term stimulus programs. Uri said earlier that it is positive that there is still some stimulus, fiscal stimulus in the pipeline. In the U.S. we have only spent one third of the total amount allocated. So this year we could spend another one third. It should be clear that by spending the same amount as last year you are not generating growth. You are just preventing that there is no negative impact now of a withdrawal of the stimulus. And we have seen during the 1990s in Japan that just with fiscal stimulus you are not re-creating growth in an economy. It's only very short term that that kind of a policy is effective.

And the same is true for very loose monetary policy. It has been very effective but already now we are very worried about the dollar carry trade and the asset price inflation that might come in several countries. So you have to quickly find other sources of growth. So that is the first reasons. There are limits to the kinds of policies that have been put in place until now.

The second reason is that it is very important to restore confidence in the global economy. And you restore confidence not be continuing to spend as if there is no tomorrow but by being very credible in the medium run, by putting on the table fiscal policies that are really sustainable, by making sure that you can take away the bottlenecks for further growth, that there is enough money for the infrastructure projects that are needed to accommodate the growth.

And the third reason, I think it's the most important one, is that this is a kind of a crisis that has the potential to create lasting structural changes. This is not a normal crisis where you have to look for a turning point which is very difficult to miss at the moment and then everything is okay again. This is the kind of a crisis that will change the global economic lynch head probably forever that is true in financial markets. It's true also for the production patterns. This is the kind of crisis where whole industries in certain countries can disappear and suddenly lose it against industries in emerging economies. And that means that as policymakers you have to accommodate those structural changes and you have to open the way to create new growth.

Now, in that respect, I'm very worried that policymakers cannot get a consensus, for example, effective climate change policies, because those are actually the kinds of policies that are needed to create a much more stable and predictable environment. And there is no decisive action there. And if there would be predictable and decisive action then you could create in high income countries new growth industries, the so-called green industries. Then you could create in developing countries new opportunities in the sense that there is a new way of securing, of creating energy security. It is not just about climate change. It is also about the global policymakers being able to guide a longer term road forward.

PETER BOTTELIER: Thank you, Hans. Philip Suttle you have the last word. What are your recommendations to make this recovery more sustainable and more robust?

PHILIP SUTTLE: Well, I obviously - the easiest thing to say is I agree to most of what has been said. Most of the good points have, in fact, been made. And I think it is fair to say that while we need to maintain stimulus policies both monetary and fiscal for the very near term there are clear implications and costs that we have been talking about for keeping on pushing. And I think the whole quantitative easing strategy which both The Fed and the Bank of England in particular have adopted is frankly a little bit of an experiment. And I think we need to be a little cautious as we look out over the next year or so about how that strategy is implemented.

Now, I think there are some considerable financial risks associated with what both central banks have been doing. But I think to kind of try and summarize a lot of what has been said I think there are three sets of principles, if you would like, I would lay out to the G20 ministers here.

The first - in many ways they are all very obvious points. But the first is make sure policy is forward looking. Don't try and fight the battles of the past too much. I often feel that when I hear policymakers making statements about what needs to be done it's sort of what they really wish they had done in 2004, 2005, 2006. Well, that's too late. You didn't do it. You messed up. And let's move on. Let's think about what can be done from a forward looking perspective taking the existing structures or the existing situation as given.

The second issue is I think recognize consistency and try for consistency. That's really another way of saying try for policy coordination. But I think there are two consistency concerns I have, to give you illustrations.

One is the obvious one of China running one monetary policy, the U.S. running another monetary policy and trying to maintain a fixed exchange rate between the two. You can't have that. You need to have some give and take and obviously in that context you need Chinese currency flexibility. And that's an illustration. It's not my main point but it is an illustration of at the moment I think the G20 policy statements are loaded with consistency issues.

Another illustration actually picks up on a point Uri just made. He said that the banks need to rebuild capital but they must lend. Well, actually what really has to happen in the banking system according to some of the new rules that are coming out is capital ratios will be going up. Simplest way and probably the most likely way of that happening is for banks to restrain asset growth. So you either want one or you want the other. It is very hard to get them both. So I infer an inconsistent outcome. I infer inconsistency.

My third point which in a sense picks up on Hans' points is that one needs to recognize that the world is in tremendous flux here. And there is a real need here for supply side flexibility. That means giving up certain things as well as gaining certain things. And I think Hans' point about green jobs and the shift in technology related to the climate change issue is a perfect illustration of that.

PETER BOTTELIER: Thank you, Philip. I would like to thank all panelists for their contributions to these five crucial questions. We have about 40 minutes left for discussion. And I would like to open it up for questions from the audience.

AUDIENCE: First point is that protectionism has been kept relatively under control. Virtually all the G20 countries have engaged in protectionist measures of various types in the United States, the American provisions, the tire case, now the steel pipes. There have been a couple of other issues. And if you go across the G20 you will find just a number of these in just about every one of the G20 countries. This remains a contained phenomenon. There have been very little sort of across the board tariff increases on specific products, etc. Part of this is WTO disciplines. The WTO disciplines buy much more on the industrial countries than they do on the developing countries. The developing countries have a lot more water in their tariffs, in other words, they can raise tariffs and still stay WTO compliant. WTO disciplines are also out there because of the possible threat of dispute sentiment. But I think in the end the control of protectionism isn't so much about the actual disciplines that are out there which can be gotten around in various ways. It is about two things. It's about the memory of what happened before and it's about the political pressure that exists.

I happen to believe, and I wrote about 9 months ago on this issue, that if we had not managed to control the global recession and the possibility of depression that occurred that the protectionist pressures would have become very, very great and in some cases perhaps overwhelming. So this is one important factor. So if you believe Desmond's artwork then be very concerned about protectionism because it is very contingent, in my view, on the state of the economy.

Let me say one more thing. While I agree that we need exchange flexibility in China and we need some exchange rate appreciation in the Asian countries in general and that this will make it a lot easier to manage the growing gap that exists between the potential of growth in the industrial and developing countries, I think that to make this sort of central question at the moment has a number of risks. One of them is exactly to animate, to add to the protectionist rhetoric and so on.

And the other is essentially to take the heat off the real questions which underlie these global imbalances which are actually more to do with fiscal policies in the United States, household savings rates in the United States and distortions within China which artificially inflate the savings rate in China than it has to do with the international exchange. The international exchange is essentially a way that these economies are adapting to these pressures and to these distortions which really have to do with domestic policies.

PETER BOTTELIER: Since the issue of protectionism is so important and potentially so treacherous, I would like to ask if other panelists have any comments on that question.

PHILIP SUTTLE: Can I make a point which is sort of very intolerant which I think is the most concerning aspect of protectionism at the moment actually in the financial sector and it's actually being promoted by many in the official sector who are saying one way to make our system safer is to ring fence it. And that you see especially in Europe. It is in a way very understandable because of some of the traumas that some of the smaller countries experienced in Europe with cross border banking difficulties. And I think if we go down that route and ring fence banking systems and impose essentially protectionism and financial services then it carries with it some pretty negative implications, the least of which I think it is fair to say that a lot of growth in emerging markets in recent years has come from the opening up of the financial systems and the introduction of best practices. Maybe that's not the right phrase, but certain practices from the mature economies into the emerging economies.

PETER BOTTELIER: That is an important comment. I would like to move to the next question. This gentleman on the second row.

AUDIENCE: Hello. My name is James Bond and I work at [INAUDIBLE] which is part of the World Bank group. We have spent the last year heavily involved in the financial crisis in East Europe. My question is to Phil Suttle. And I actually want to ask him about what will happen to the PIIGS in Europe: Portugal, Italy, Ireland, Greece and Spain. What would -- sort of a science fiction from Philip -- in terms of what unwinding of the Eurozone would look like if the tensions in the zone become excessive, unmanageable and the whole place falls apart?

PHILIP SUTTLE: Good question and I'm sure Desmond will have a view on this, as well. I mean, I worry that precisely because those links are so tight, in other words, we have legal structures and physical structures that aren't easy to unwind even compared to, say, Argentina going off convertibility or Britain going off gold in 1931. This is actually a tougher nut to crack in that sense if you believe the currency flexibility was the way to go. Actually reversing what was done with introduction of the euro was phenomenally tough. So I think what it leads one to is the conclusion that you sort of - I wouldn't use the acronym, but those countries that you mentioned they have to tough it out. And you're looking at multi austerity.

Now you could say we have had multi austerity in key parts of Europe before and it turned out to be not too bad. I mean, there are countries, Ireland being an example itself, that achieved a massive reduction in its budget deficit in the 1980s over a number of years and somehow the countries survived and actually flourished out of it. But then you have the ability to converge interest rates. They started off high and converged on German levels. You also had an opening up of the economy to massive inflows of FDI. Neither of those two offsetting financial support seem to be there. So it looks to me like this group of countries is in for austerity on the fiscal side not just for a year or two but for an extended period. But Desmond maybe you have these on the unwind issue.

DESMOND LACHMAN: I was trying to strike an optimistic note to the seminar until that question was raised because I don't think it is a question of if this is going to happen. It is more a question of when it is going to happen. And basically the stakes are incredibly high. The reason is that if any of these countries were to be forced out of the euro and have to be borrowing in their own currency what that would mean is instant defaults on their sovereign debts.

Now, what we are talking about is not a small country like Dubai or Iceland or something of that sort. We are talking about serious countries. We are talking about something like Spain which is very large. You are talking about a huge amount of debt. So what it would do is it would sink the whole of the European banking system. It would be real Armageddon. And that is the reason that the ECB is going to fight it and hold its nose despite the fact that we are talking about solvency issues. We are talking about unsustainability issues. The prospect of having this kind of cataclysmic occurring within Europe is going to cause the ECB to continue pumping in money until they get tight.

The reason that I'm very pessimistic about this from a long term point of view is the size of the imbalances that are involved and most importantly the amount of international competitiveness that these countries have lost. So if you are looking at countries like Ireland, Portugal, Greece, Spain, they have lost something like 30 percent of competitiveness against Germany. What they have got to do is they have now got to regain that competitiveness against a country that doesn't believe in inflation. So what it means is that you have actually got to get prices and wages falling by 30 percent which is then going to complicate their fiscal problem.

Unfortunately when you get to my stage of - the stage that I'm at in my career you've been to this movie a number of times. And the last rendition of this movie I saw was at the Argentine Convertibility Plan which everybody said wouldn't fall apart and when it did fall apart you really got a debt default. I just don't see how - it’s just the inconsistencies are just so great that if you try to go the austerity route, you try to tighten your budget, what you do is you drive your economy down. If you drive your economy down you lose your tax base so you don't really gain much by the tightening.

So I think that this is a fool's errand but the way in which it will play out is the ECB will keep kicking the can forward until they realize that it's not just Greece that they've got to be supporting but it's Greece, the whole bunch of them, four or five countries which involves huge amounts of money. It's going to be a huge transfer from the north of Europe to the south of Europe and this is going to have a political dynamic of its own. I can't imagine that Spaniards are going to tolerate unemployment at 20 percent and rising forever. They are going to be asking. There's got to be a better way than this. And that's basically what occurred in Argentina.

PETER BOTTELIER: Uri, I would like to suggest that maybe you would schedule a seminar like this on the future of the euro. You can invite Desmond again. Next question from the audience. This gentleman here in the front.

AUDIENCE: Barry Wood, RTHK in Hong Kong. I would like to ask Phil and Hans to expand a bit about the power shift to the emerging markets, particularly the bricks. Why do you really think that's happening? It's not just debt in the United States; is it? I'm not persuaded that domestic demand is going to rise in China and Brazil and thus sustain this. And if the United States is going to grow at a low level aren't we going to see commodity prices decline from these current levels?

PETER BOTTELIER: Do you want to go first, Hans?

HANS TIMMER: Well, why is it happening? Let me first say why it is not happening. Many people think that this was happening because of export growths, because either through manipulation of currencies or through other impulses to stimulate a manufacturing sector in China, for example. These emerging economies were basically boring growths by exporting their way out. That's a complete misread of the data, in my opinion.

And I would say that that line of thinking is actually another danger against the trading system as we know it. I mean, we talk about protectionism. Often we talk about limiting the imports. But there is a lot of discussion now about rethinking export growths which also could be a threat against a trading system. And, again, it is a misread of the data. Developing countries including China but it was happening in many, many more countries, growing two and a half times, almost three times as fast as the high income countries over the last ten years before the crisis. And they accelerated their growth while nothing was happening in the high income countries. Growth was not accelerating and import demand was not accelerating. This was basically happening because of internal reforms which unleashed productivity potential that they have not used yet. And through enormous increase in productivity and with that an increase in the supply of products they were gaining market share everywhere in the world and they were increasing trade, but not only their exports but also their imports.

As I said, I think, earlier on, if you look at China at the moment despite all the discussions about their change rate manipulation, their imports are actually growing much faster at the moment than their exports. So this was happening because of reforms in their economies which enabled them to catch up in productivity level to what was already achieved in other countries creating huge growth potential, making it possible to grow with limited inflation and actually keeping inflation very low all over the world.

Now, as a result of this process they have become very important not only for their own economies but actually very important for the world economy as a whole. And 2007 was a very good illustration of that. The recession or the downturn in the United States started already early 2007 or you could argue at the end of 2006. That was the moment where housing prices start falling and as a result of that in 2007 there was no growth in consumption. There was no growth in import demand in the United States and still the United States was growing because there was double digit export growth. And to a large extent that was export growth of investment products going to the emerging economies. And they were still growing despite the fact that there was no domestic demand in the United States. It was a good illustration not only that the rest of the world did not depend on the U.S. consumer, but actually the U.S. started depending on investment demand in the rest of the world.

And what happened was the crisis that started with the Lehman Brothers was that suddenly that investment demand that was so dynamic in emerging economies stopped everywhere in the world. People stopped investing including in the developing countries. And that resulted in the very sharp downturn in the high income countries, also, especially in Japan that is so much specialized in the investment products.

Now, that has to be turned around. And for the world economy to grow again you need to go back to that very fast growth in the emerging economies. There is a potential there. The big danger is that too much perhaps in the short run it is still driven by stimulus. And there is more needed to go back to that very fast growth that we saw before the crisis. But it is a real phenomenon and it is homegrown.

PETER BOTTELIER: Philip, would you address the same question?

PHILIP SUTTLE: Very quickly. The image that I have been sort of pushing and living with for the last couple of years is this is a world turned upside down in so many ways, not the least of which is that we actually have the official sector in the emerging world supporting banks in the mature world which is a tremendous inversion of the way official capital support acted in the 1990s. But I think the point I would really highlight here is that I came into this business in the early 80s and for the first 20 years in my career the world was all about financial crises in the developing worlds, starting with the LDC Debt Crisis and then morphing into the various extreme crises of the '90s. And the mature world was sort of sitting there kind of smug and kind of ticking along. Sometimes it did well. Sometimes it did poorly and inflation was the concern and all of this. But the emerging world was a world of financial instability. And China was a little bit of an exception but it was particularly true in Latin America.

And I think part of this world turned upside down story is that we have seen a dramatic inversion of that financial instability. And so a big part of the emerging market strength theme is the benefit that this region is now enjoying from the long run reestablishment of financial stability. And it is very paradoxical because that benefit is coming at the very time that we in the mature world are suffering all the traumas of financial instability. It need not have happened that way, but it just so has happened that way. And Brazil is a very good case and point where after many years of hyperinflation and total destruction of not just the capital markets but also, frankly, their banking system for the last 10 or 15 years they gradually reestablished an orderly financial system. And the longer run benefits of that in the form of financing to the broader economy but especially to the corporate sector, those longer run benefits are really now just coming through and they are coming through strongly. And, as I say, it so happens that it is happening at a time when in the mature markets we are going to other direction.

Is that sustainable? Well, it probably is but it's not inevitably sustainable and it very much will be a function of: Will they get back into the bad old habits that they themselves got into in the early 70s and that we got into in the last decade?

So I think coming back to this policy challenge point one of the big issues that we face in the world is reestablishing financial conditions in the mature markets but also insuring that the buoyant financial conditions that we have out there in many emerging markets need to ensure that those don't become too overheated.

PETER BOTTELIER: The next question, the gentleman in the middle there.

AUDIENCE: Hi. I'm John Ream from Morgan Stanley. The panel hasn't talked about tax policy at all. And I have two questions, Peter. The first one is: Do you think that governments will ignore growing evidence that low tax rates foster economic growth in interest of fiscal austerity going forward? And secondly, as economists, do you think you should be considering higher taxes in your growth rate forecast going forward?

PETER BOTTELIER: Thank you. This is an easy question. Jorg, you are the most obvious candidate to have a first go at this one.

JORG DECRESSIN: It is clear that a good deal of fiscal adjustment needs to take place. I have already said that. Ideally this should be performed along two dimensions. One is an entitlement system. The other one is actual adjustment. And when it comes to actual adjustment everything has to be on the table, expenditure cuts as well as tax increases.

Now, the relation between taxation and growth is a very complex one. It's not straightforward. And there are many ways in which you can raise more revenue without hurting growth. I mean, what you really want to, then, do is remove forms of taxation that end up being distortionary or eliminate subsidies or tax expenditures, as we call them.

So it is really the interaction between - what I want to leave you with is the interaction between the tax system and growth is complex and it's a function not only of the tax rate but of the structure of the tax system. And I'm convinced that in many countries you can achieve improvements in that structure that will also bring about more revenue and at the same time not hurt growth. But that, of course, will entail taking on special interests and all sorts of other things that are very tough in the political arena.

PETER BOTTELIER: Desmond, would you like to add to this?

DESMOND LACHMAN: I think that the question raised is a great question because it really raises the issue of what is going to happen to potential growth in the industrialized countries over the next decade. I don't think, though, that we've got any alternative. If you look at the budget numbers I would agree with what Jorg said. You would just look at the debt numbers, where we are going. United States, according to the congressional budget office, we are going to see a doubling of the debt to GDP ratio from something like 45 percent to something like 85 percent by the end of the decade. And then we've got to deal with the entitlement programs that are going to cause it to probably double further over the next decade.

So I agree that I don't think that now is the time to be talking about tax cuts which would just be widening those kinds of deficits. I think that if we've got commitments on expenditure what we should really be doing is refinancing them. And this is really a concern that I've got with this administration is that we've got a very precarious budget situation that they seem to be rather cavalier in adding additional expenditures that aren't funded. And this could very well - I'm frankly worried about the rating agencies indicating that if the United States doesn't come up with a medium term adjustment plan the United States could lose its AAA rating. So I just don't see a way around having to engage in expenditure cuts, revenue increases to put the public finances on a better footing. Otherwise what we are really doing is we are just inviting a major crisis down the road.

PETER BOTTELIER: Uri, do you have supplemental comments on this critical question? Too controversial?

URI DADUSH: No. I think these are very good comments. I don't have much to add.

PETER BOTTELIER: Next question from the audience.

AUDIENCE: I'm Jean Hanson from [INAUDIBLE]. I have a question for Mr. Dadush. I remember that you said China needs to improve international influence in the world. I want to know how. Do you have some specific suggestions for the Chinese policymakers? Thank you.

URI DADUSH: Well, my observation is a longstanding one that comes from many years spent in frustration trying to nudge the [INAUDIBLE] negotiations along. And noticing two things, one that China is pretty much destined to be the world's largest rating nation. If it is not already, it is going to be within the next several years. And it is in a sense the free trade power if you relate to this concept. The United Kingdom, Britain was the free trade power in much of the 19th century. The United States was the free trade power in a good part during the second half of the 20th century. And the free trade power is basically the world's largest trader but it is also a competitive trader. It is a trader that is confident. And my point about China is that they could be doing more, could have done more to promote the negotiations and to recognize that no country has a greater interest than China in a rules based and free trading system. And that's where that particular point comes but I think the point increasingly can be generalized in so many areas, in climate change. China is now the biggest emitter of carbon dioxide and of green house gases. Therefore moving forward on the climate change negotiations will not happen unless China together with the United States, of course, which is the second largest emitter, come to some sort of agreement especially since these two countries are the opposite, in some sense at the opposite side of the spectrum developed and developing.

So it's really the point about China recognizing on the one hand its growing influence and I think this is obviously happening, but on the other hand recognizing that they have a very important stake in this system. And that unless the conditions are created where rapid growth in the world is not impeded by whether it is environmental degradation or the absence of adequate rules in trade and finance that China needs to play an important role. And that is why the currency issue even though I am on record saying that an appreciation of the [INAUDIBLE] will do absolutely nothing to correct the current account deficit of the United States because it is a completely marginal issue. The main issue in the United States is domestic policy.

Even though that is the case it is important that China move in the direction of greater exchange rate flexibility for China itself and in part to diffuse the protectionist pressures that are becoming more and more important. But it is very important and it will help China to move in that direction.

PETER BOTTELIER: If I may add because I'm focused on the China questions almost full time even though I am the moderator and I completely agree with Uri's responses, but I would still like to add one or two other comments. Many of the senior leaders in China I think are still to become used to the idea that China has become a major factor in the world in every dimension. It's almost certainly already the second largest economy in whatever way you measure it. It's probably the largest trader, the largest CO2 emitter and so on and so on. But yet in the mindset of many of the senior people China is still a struggling developing country which has to fend for itself. China now has to, I think, adopt a mindset where it accepts for itself the role of a major player in all dimensions of the world economy.

With regard to specific recommendations the comment that I would like to make is that the exchange rate comments that Uri made I support but still I think the issue is not unimportant but for different reasons. I believe that a flexabilization of the exchange rate policy of China is mainly a Chinese interest. I believe it will help China to move in the direction of the structural reforms that are clearly necessary in that country not only for China but also for the rest of the world. Let's not forget that China's population is larger than that of all OECD countries together. So if China plays the cards right, pursues structural reforms in the direction of greater dependency on domestic demand rather than export demand, especially domestic consumer demand, that will be good for all of us. Thank you.

Next question. This gentleman here.

AUDIENCE: Thank you. It's Bob Davis with the Wall Street Journal. We've talked for years and years and years about how growth in the rich countries effects in a positive fashion growth in emerging markets. I'm wondering in the context of the U.S. where most everyone here thinks there will be slow to at least moderate growth, what are the linkages from the emerging markets to the U.S. in such a way that you can see -- or are there such linkages -- that you can see 8 or 9 percent growth in China effecting in a positive way growth in the U.S.?

PETER BOTTELIER: Philip, would you take this question?

PHILIP SUTTLE: The linkages come through the trading system. And these emerging economies although their weight in global GDP has been rising very rapidly we are focused on that, they also have a weight in global consumption. I mean, it's smaller relative to the weight that they have in global GDP, but it's still appreciable. And if you have consumption growth rates on the order of 8 or 9 percent in China this does make a difference for the U.S. economy.

Now, that said, if you put this into perspective then you will realize that the extent to which the emerging economies can do something for the advanced economies is still relatively limited. Let me give you some numbers.

If you take consumption in all the countries that ahead of this crisis have been running large current account deficits and are now experiencing increases in savings rate that are quite large, too, these economies are compromised by the U.S., the U.K., the Irelands, the PIIGS - sorry, Portugal, Ireland, Greece, Spain and sorry. The acronym is a bad acronym, actually. Then all of the Eastern Europe economies - you take consumption for all of them and then you put it in relation to consumption of China. The consumption of

China is one third. So China alone cannot do the whole adjustment. The consumption is still too small even though it is growing very rapidly.

So it does make a difference for the U.S. economy but it cannot pull the U.S. and all of these other countries out of recession. That's the way we see it.

AUDIENCE: Is there also a financial - [INAUDIBLE]

SPEAKER: There are two clear financial linkages, one of which I think is a little bit, you could argue a bit of a mixed blessing which is the provision of debt capital into the economy. And over recent years obviously the emerging markets have been the major buyers of primarily of treasury paper, especially in the last year. Before that also mortgage backed securities less obviously since the crisis. And that has kept interest rates down. Now, as they say that may have been a mixed blessing. That may have contributed to the whole problem.

But I think one other financial link which is sort of somewhat underappreciated is the support given by profitability abroad to U.S. corporations and thus to the U.S. stock market and thus to U.S. economy more broadly I would argue. Good example, probably the best example I could think of off of the top of my head, maybe not a particularly good one, is General Motors. General Motors has already gone bankrupt in this country and has been a bit of a disaster but its operations in the emerging economies, most especially in China - I mean, it didn't save it but they were part of a stabilizer. And I contrast that actually with their operations in Sweden, for example, which they basically have had to walk away from. So I think it's an interesting contrast showing the supporting role being provided to the corporate sector by the emerging world.

SPEAKER: I would just like to make the point that rapid growth in China needn't be supportive of the United States economy, particularly if it's an export led growth that leads to a very large current account surplus. And that really has been the pattern in China. Running current account surpluses means that effectively what you are doing is you are taking demand away from the United States. You are sucking it out of the United States.

And I think that when you've got a stimulus package that goes in for excess capacity, excess supply that is not going to be very supportive to the United States going forward.

PETER BOTTELIER: Uri?

URI DADUSH: One more point. All the points so far I think have related to short term considerations meaning boosting aggregate demand in the United States. This forgets what I believe is the most important benefit of the growth of developing countries which has to do with the supply side of the economies. Essentially as China goes, as India goes the number of people that are able to buy products, sophisticated advanced consumer products produced in the United States or for that matter in Germany or the United Kingdom increases exponentially.

When I was at the World Bank working with Hans we produced a report that illustrated how within 20 years now something like 90 percent of the middle class in the world somehow defined - I don't want to go into all the definitions - but these are people that can buy sophisticated products. Ninety percent of those people will reside in the developing world whereas today that proportion is much, much smaller.

What this means fundamentally is that the United States will be able to pursue the natural path of its comparative advantage which is the development of sophisticated products and import the low cost stuff that can be manufactured much better elsewhere.

So what we are talking about is we are not talking about the growth potential of the United States in the course of the next 12 to 18 months. We are talking about what the standard of living of the average person in the United States is going to be 20 years from now, 30 years from now and what will determine that. And the integration with the developing countries probably holds the largest opportunity to raise those living standards in the medium term.

SPEAKER: Just because it is such an important issue I want to underline two things. First of all, that there are limits to what you can get out of macro models with the standard rules of thumb through the trade linkages. As I said before, one of the most important mechanisms in the current crisis was the sharp drop in investments and the fact that it's the high income countries that are specialized in the production of investment goods. If you think through that mechanism which is more detailed than in a standard macro story then you see that the role of the emerging economies is far bigger than what you get when you just look at the aggregate economies. So that's the first point.

And the second point is very much related to what Uri said about the supply side. The sole focus on the current account and the surplus on the current account and thinking through impact of aggregate demand in high income countries is very misleading. That would be an important story if a country like China was trying to increase its share in the same cake by promoting export like policies. But what it actually does is it increases the cake for the whole world. And everybody benefits from that. It's not just emerging middle class in the developing countries themselves. It's also at the benefit from the people in the high income countries and it comes through lower prices. But the real wealth is increasing because somewhere in the world productivity is increasing and the whole production is increasing. And that's the process that is most important at the moment.

PETER BOTTELIER: Thank you. Unfortunately we have run out of time so I will have to bring this seminar to a close. I would like to thank the audience also on C-SPAN for tuning into this very, very timely and important seminar. There is no time for any summing up other than to say that perhaps if it were to Desmond Lachman he would put three question marks behind the Happy New Year whereas Philip and Uri might be content with no question mark.

SPEAKER: An exclamation point.

PETER BOTTELIER: Whereas Hans and Jorg are happy with one question mark. Thank you all for attending this seminar.