

European Interview

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G20: "There can only be an overall solution to the crisis if there is cooperation"

Interview with Jean-Paul Betbèze - Professor of Economics at the University of Paris II - Panthéon-Assas.

The next summit of the 20 industrialised and emerging countries (G20) will take place on 3rd and 4th November next. These 20 countries represent 85% of the world's economy and 2/3 of its population. The declared goal is to discuss the world's economic situation and to come with joint responses. What can we expect of this?

The main idea behind this meeting is that the G20 takes on the full responsibility of its task to coordinate the world's major economies, in order for them to emerge from the present crisis. It follows on from the G7, which did not include any of the emerging countries – but the crisis, like the G7 crisis, has made this necessary. Moreover the G20's role does not just comprise sharing a diagnosis, but goes deeper in drawing up a cooperative situation to find solutions to the crisis. In the G20 the six so-called strategic countries (USA, China, Japan, Germany, France and the UK) will communicate their choices and forecasts, the idea being to see how coherent these choices are with those made by the others. We see, for example, that it means ensuring that questions about the exchange rate of the Chinese currency, the balancing of American accounts and the strengthening of the euro zone will be at the heart of joint discussion, with everyone helping to come up with some answers.

There can only be an overall solution to the crisis if there is cooperation and everyone has to be convinced of this – which means pinpointing areas of tension and negotiations in order to draft joint solutions.

2. The USA's stance on how the euro zone should act, and the calls for rapid response have been a source of irritation. The comments made by Timothy Geithner, Secretary of State to the American Treasury, were perceived as a rather unfair kind of interference. What should we think of the American situation?

A few home truths have to be said. The USA was surprised by the severe slowdown of its economy in the second quarter, by the idea that the crisis was worse there than forecast and that recovery was also slower than planned,

with the risk of relapsing into recession – which they wanted to avoid at all costs. At the same time, from a political point of view, budgetary policy was in stalemate because of tension between the Republicans and Democrats. So there remained monetary policy: action on reducing long term rates first (with the upkeep of commitment to funding the property market and "operation twist" to reduce returns on the American ten-year loan), then more political action on the rise of Yuan, which was rejected by the Chinese, and political action also on American liquidity, with the emphasis being placed on the dangers of funding European banks which rely on this. The latter point, which is as novel as it is political, drew the attention of the financial markets towards the European banks, at a time when problems in Europe were already acute, which did not really help matters. We might think that the USA undertook diversion tactics towards the euro zone, at the risk of worsening an already fragile situation. This then led to interference.

3. France qualifies the G20 as "an economic steering committee". In your opinion does this match reality?

This is France's idea of the G20, it seems to be a good one and one that is shared. But in fact reality supposes a practice that we have guide in that direction. This seems to have been occurring over the last few months. Indeed the crisis has accentuated tension, but it has also shown that action cannot be taken alone – that choices and the potentially perverse effects of these are interdependent (for example Basel 2 and Solvency 2). There cannot be clear sighted governance without knowledge of all of the issues at stake – so that they can be overcome. There is no simple answer; above all there cannot be solution without cooperation.

4. "Democracy does not follow the same time scale as the markets". What do you think a reasonable time-scale for the G20 members to agree in defining an effective solution?

Democracy will never follow the same time-scale as the markets; however we cannot say that the markets do not

ask democratic questions. When they show concern about deficits and public debt and even the weaknesses of some banks they are highlighting, often brutally, some serious problems. This also does not mean however that they give early warning, that they see interdependency clearly or, moreover, the possible perverse effects of the proposed regulations, nor that they make any specific warning about the decline of competitiveness of one economy or another. So, they do not say everything, they are short-sighted, they are excessive, they are fickle – we all know this series of critics; but we also know that they don't always get everything wrong.

The G20 should therefore put forward a transparent, reasonable timetable to reduce local imbalances, with each accepting to do his share. For example, China, which is growing with an undervalued currency realises that this is importing inflation, which is not the best solution. But raising the value of its currency means supporting its domestic market and managing the social effects that this kind of action leads to. And it can only do this if the USA commits to reducing its own imbalance between savings and investment.

5. The accumulation of macro-economic imbalance and shortfalls in financial regulation demand new measures worldwide. What are the priorities?

We are not really speaking of "shortfalls in financial regulation" but rather of shortfalls in surveillance. Indeed the sub primes were created in the USA and it was there that shadow banking developed. The imbalances were both the cause and consequence of these lacunas. To settle this, apart from having macro-economic policies, we have to prioritise surveillance (notably lending conditions) and put less emphasis on standards such as Basel 3 and Solvency 2, which will make loans more expensive and reduce the funding of limited companies, which is not really favourable for supporting growth. The priority is to draw up and present a plan to solve the present problems, which means combining the reduction of public spending and support to private activity with the corresponding sound funding. Hence it is a question of moderating and explaining because anticipation management is decisive in this domain.

6. Since 2008 the Franco-German couple has positioned itself as the EU's motor in this time of crisis. How do you think these two countries should react to reform the governance of the euro zone?

It is an economic and also an ideological motor, which

derives some of its strength from its heterogeneous nature. Beyond that, choices will have to be aggregated and other countries convinced of the strategy chosen to solve the crisis, thanks to the consolidation of European integration. A major share of work will lie in convincing the markets. This will consist in analysis, education and confidence, in the knowledge that it is decisive for economic players to have an idea of the time-scale involved – at least five years –, and also of the rules of transparency and equity of the necessary adjustment mechanism.

7. On a European level which is the best adapted bank recapitalisation strategy? Should the financial support fund (Soffin) be used to inject liquidities into the banks as in Germany? Or should the banks' savings guarantee funds be centralised and should the financial sector bear the cost as in Spain? Or should it be achieved via sovereign bonds such as the "Tremonti bonds" as in Italy in 2009? Or should it be via nationalisation as with the Royal Bank of Scotland, Lloyd's in Britain or with Dexia in Belgium?

We should only recapitalise banks that need it. There is no point in worrying everyone, which just weakens confidence in all of the banks, with the ensuing effects on funding growth. In order to measure the volume of own funds necessary, the strength of the financial systems has to be tested, which will reveal that the universal European bank, which combines a retail network, with a reduced sphere of funding activities, is extremely resistant to shocks. The banks which have gone bankrupt did not follow this model: so in Europe we should not expose ourselves by criticising those who have withstood the test! Then and only then, might we look into what is necessary: we shall then see that requirements are lower than the forecasts being announced.

8. Dexia has demonstrated the limits of the European stress tests since it successfully passed these in July 2011. Are these studies enough? How could they be improved?

Because of how it is put together a stress test depends on the hypotheses which define it. The previous tests were therefore hypotheses based on the sovereign debt crisis and the slowing of growth, not on the decline in liquidities which came along later. This does not mean that these

tests were not useful, but because of the way they have been put together they cannot reveal everything, because they cannot forecast everything. In any event we should note that some banks which failed these tests have not been tested since and this is a serious problem. The moral of the story is that progress has to be made in terms of these tests but likewise in terms of the follow up with regard to what they reveal and above all in terms of surveillance. This does not mean being able to test against all shocks but adopting a reasonable, cooperative approach.

9. What effect will the depreciation of the Greek debt have on banking results?

Any depreciation is a loss, as it will be for all of the other bond holders. At the same time it enables the support of a country's activity, therefore guaranteeing the reimbursement of the rest. However this depreciation should not be too great otherwise there might be a double domino effect – on the banks which will witness excessive depreciation, on the countries in which the banks are established – which might also require specific treatment. Depreciation helps revival, under certain conditions, but this is not automatic.

10. China and India are in a position to purchase the European debt. How do you see the new deal between the major powers? Should we be worried for the euro zone?

This purchase is not a bad deal for these countries because it comes with a discount. At the same time this support is also political in nature. It is a way for them to enter into play, without forgetting however that most support is undertaken by the Europeans themselves. What is happening is a strength building exercise for Europe, with each country understanding what it costs not to follow the community rules of balancing public accounts. But it is not just about this. Every country also sees that solidarity is being established, since the exit by a country from the euro zone would undoubtedly be the prelude to its collapse, which everyone wants to prevent at all costs. Finally for the euro zone to be stronger, it has to be simpler, more responsive, more transparent, and closer to European citizens. But when we see the Greeks demonstrating, this is not the image that is being conveyed. Of course a lot is being asked of them, but this is being made possible because of the work being done by other euro zone members. It is a salutary act for all, in the real sense of the word, and primarily for them. We have to ensure that Europeans are the first beneficiaries of the rescue of the zone which is being organised right now. And let's hope that lessons will have been learned from this.



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