

REJOINDERS AND QUESTIONS FROM THE FLOOR

MORRIS MOTTALE: A question for all the panelists. What is next? I'm sure a lot of members of the audience came actually looking for answers to forecasting any future developments in, I hate to use the word, international finance, let's say, international economy.

NICHOLAS HASKO: It seems to me that one key issue in this discussion is time dependency of economics as a discipline. How does one overcome this sort of things? It seems that as time goes on, it will be more and more difficult. Certainly, what you're proposing is important, but more regulation or more responsible journalism won't happen by itself.

JOHN AUXILLOS: My question is about what is next in mortgage systems in the United States. George Soros published a book last year, I think, and suggested that the U.S. system should incorporate some elements of the Danish mortgage system where, in the process of mortgage securitization, credit risk is retained at the origin and the interest risk is left to the bond traders in the market. What do you think of this in the context of U.S. and also world finance?

UNKNOWN: Professor Werner defined the Fed as a banking cartel. Would you elaborate on that?

ROXANA CAZACU: I have a question pertaining to regulation and rating agencies. How were some of the companies rated and where did they finally end up?

REBECCA SELF: I was interested in the line in your PowerPoint presentation about returning the power to the people, and I was thinking about microfinance or a variety of different alternative currency movements. I wonder how you envision returning the power to the people.

RITA LYSENKO: Lord Skidelsky said that decision making based on expectations is usually not so efficient. We do in fact make decisions every day. If they're not based on expectations, then they are based on what?

LURATI: Since most of the questions were economic, I will address the point about why people didn't hear what journalists were saying. An aspect I didn't mention is that journalists had the feeling they really didn't have the access to the data necessary to do their jobs. As Richard Werner pointed out earlier, one important piece of data that was available in the past but not today is the quality of loans. It is not enough to say, without having real data, that we have a hunch that what is going on out there is not solid, that some households are not creditworthy. In fact, journalists who can't back up their hunches because the data has disappeared find themselves having to work with guesses instead of with solid evidence. And this changes the work and efficacy of journalists dramatically.

If you want media to back up a certain agenda, you have to put them in a position to be able to work with data. Financial activists like CalPERS (California Public Employees' Retirement System) or Robert Monks or Ethos in Switzerland have understood this, and what they do is aggregate data for the media. There are several ways to do this. For instance, create rankings based on relevant indicators. These rankings can be generated using criteria defined in standards and regulations. This is what Ethos does, for instance.

Another approach corresponds to what organizations such as CalPERS do. They monitor the companies listed in their portfolios against specific performance criteria they consider relevant. In case the criteria are not met, they provide the media with these data in hopes that public exposure will force the company's board and its top management to change. (Unfortunately, CalPERS has been focusing more on shareholders' favorable criteria than on long-term criteria that have to do with the intrinsic value of companies.)

To conclude, I think the media will be able to contribute to the creation of a new paradigm, if what I call “external aggregators” such as think tanks or activists help them access the strong data the financial system does not provide.

What I like about Obama is that he acknowledges that the problem is complex. He thinks there is a collective responsibility and a need for cultural change. He acknowledges the complexity of the reality and the current situation. And this doesn't provide an answer tomorrow morning. I believe this is the big difference between progressive thinking and conservative thinking. Answers are not simple. They are complex and require intellectual honesty.

WERNER: Thank you very much. There is a list of questions. I will be extremely brief on each. The first one was about forecasts, basically what we think is going to happen next. Fundamentally two scenarios: one is that policies are changed and things improve. The other is that the decision makers don't adopt all or some of the policies which are necessary and sufficient, and therefore there won't be a lasting recovery for a while. Having lived in Japan for 12 years, throughout the 1990s, I am constantly amazed by the refusal of policymakers, especially central bankers, to accept facts or revise wrong decisions. Next year, as I said, Japan will be in its twentieth year of recession, so unfortunately that is a possibility. Of course, what we hear from the Fed and also from the Bank of England concerning expansion in credit creation sounds much better, although they express it slightly differently. However, on March 23 the Fed and the Treasury released a short one-page statement, timed to coincide with a huge release by the Obama administration on one of the big banking bailout programs. It got zero coverage in the mainstream newspapers or television media. In this statement the legal framework is being created for the Fed to send the bill for all its purchases of toxic waste, bad assets, banks, insurance companies, etc., to the Treasury, transfer the whole lot to the Treasury, therefore demonetize it, increase national debt by a couple trillion dollars and create a big, big burden on the economy. So, that's a bit worrying. Hopefully they did that only because they thought it would help stability. However, the alternative scenario of a continued long recession does exist. We just have to watch what is going to happen now. How can we implement some of the policy advice that we have given? I would say the main thing is that the general public needs to become more aware of some of the key facts, such as that 98, 99 percent of all the money is privately created by private profit which maximizes decision makers who may not care at all about national welfare, social welfare and the macro outcome. If the public is better educated, and of course this is where economics is to blame, but also the media and others, then hopefully politicians will get pressure from grassroots. That's how everyone in this room can contribute; it's our responsibility to spread this knowledge and make more people aware that big things are going on.

The question about mortgage-bond marketers referred specifically to Denmark, where basically it is an approved structure that if the issuers or the originators of the mortgage, the debt, maintain a stake in the risk and therefore potential liability, a strong incentive is created for them to make sensible decisions. Something like that is required if we want to continue down that road at all, and perhaps we may not want to wish that.

I was asked to elaborate on the fact I called the U.S. Federal Reserve a banking cartel. If you take any definition of cartel, then, yes, I stand to that. Certainly, when you look at its history, that's how it was created, and also in its ownership status. Until 1939 the majority of central banks in the world were privately owned. With the Fed it is perhaps a bit more obvious how this happened. The Fed for all intents and purposes is the New York Fed, which is owned by Wall Street banks. So if we consider that the New York Fed bought Bear Stearns and gave a massive guarantee, I believe it was 20 or 30 billion, a minor figure these days, to J.P. Morgan, then we should remember that J.P. Morgan is probably the single biggest owner of the New York Fed. You can look at this as you wish, but these are some of the facts.

I think that rating agencies were also part of the collusive network of people and entities with conflicts of interest that basically helped to flog, as Lord Skidelsky put in much better terms, the fraudulent products that were being pushed on innocents. Of course it's obvious because they get the money, the fees, from those who want the rating, so of course they always have this incentive problem.

How can we return the power to the people? Specifically I was referring to the power to create money. There are different possibilities. One would be to take it entirely away from privately owned banks. Actually, in a way, this is what Friedman was also saying when he talked about 100 percent reserve requirement banking. Abolish fractional reserve banking and make banks more like fund managers without the power to create credit. Then use the government finance ministry to expand or reduce the money supply, much like the inventors of paper money used to run their economy, the Chinese economy, where the government had full control over the money supply when it conducted open market operations already in the tenth century. There is a fantastic description of this in Marco Polo's *The Travels*. Since he was a merchant he provided a good technical description of the first open market operation in a paper money system. So, there are other possibilities. The technicalities are very simple. The biggest obstacle, coming back to a sort of power-related issue, is that the vested interests are behind the current system. How do you overcome that? By informing people, by talking about it, by having symposiums like this, I think. Yes, Francesco pointed out that data on the quality, the disaggregation of credit, used to be much more easily available. Because of the increased independence of central banks, not surprisingly, as I was predicting in the Japanese case, they were actually able to reduce the number of relevant, pertinent data series on credit creation, sectoral allocation. In Japan they just entirely abolished the monthly data series, which had been very good. That has been a problem, so central banks need to be reviewed in their excessive power and their independence. Thanks very much.

FULWILLER: In terms of what's going to happen, I should qualify my presentation. I wasn't intending to imply that the paradigm I presented would become the consensus any time soon. I was simply presenting a paradigm that could account for what's happened and the sort of problems that Buiter was mentioning in a way that was not ad hoc. Given that I am a Keynesian, I have an expectation about what is going to happen, but I also know it's going to be wrong. But it seems there are some things going on: we are going to have bigger deficits in the future, we are going to have, certainly we are having right now, some kind of discussion about systemic regulation, something that hasn't been discussed for a while. Where those debates go is anybody's guess at this point. Given what Richard just mentioned, who are the people at the table in the discussion? J.P. Morgan, Goldman Sachs and that sort of folks. So some of my ideas and maybe some of Richard's may not get a whole lot of discussion, at least in the short term. With regard to what's going to happen, I find interesting this discussion in the U.S. about getting finance and banking going before anything else can work. Back in the early nineties when the U.S. had a banking crisis as well, in the savings and loan industry, we never said we had to get banking going: we closed down banks and we had them bought out and so forth. Then the U.S. Treasury Secretaries went over to Japan and said, "You guys are propping up these banks with toxic assets. What are you doing?" We have to do what we did in the early nineties. And so here we are 10 years later, doing exactly what Japan did. Bill Black, a professor at UMKC who was formerly a high-ranking regulator, made that point recently.

I think there's going to be a debate at some point about deficits, and that kind of worries me if the Obama team is like the Clinton team, essentially the same people, or descendents of the same group. Ever since Clinton cut deficits and the economy performed very well in the late nineties, democrats have changed their tune to believing that deficits are really bad things. For some reason the fact that we had a stock market bubble creating capital gains and tremendous tax receipts from the capital gains, they missed that one. So, it would be an interesting debate.

About mortgages: I think mortgages are very difficult things for people to hold, at least in the U.S., because you have the opportunity to prepay mortgages. If interest rates rise and you are holding a mortgage, the market value just fell; if interest rates fall and the borrower refinances, you are left with a bunch of money that you have to reinvest at a lower rate. So, if interest rates rise or fall, you end up with trouble of one kind or another with mortgages. Recognizing that, in the U.S. some institutions, such as the savings and loan industry, were designed to hold mortgages. When that went belly up we had government-sponsored enterprises like Fanny Mae and Freddie Mac that essentially took over in the early nineties, although they already owned quite a few. They accelerated significantly from the early nineties through the present period. So, we haven't figured out a great way of designing the institution that is going to hold mortgages in the U.S. system.

That leads me to the rating agencies, of course. The traditional method of banking used to be to lend on the basis of credit analysis within the bank. Then the loan criteria began to be based upon "What can I sell? What can I sell and what can somebody else package as a highly rated instrument?" That changed things considerably. So the rating agencies had a huge role to play because if they had rated things differently, of course, the outcome might have been different. Their excuse was, well, they didn't have any data previous to 2001 on subprime and so they were rating things because... That goes back to expectations again, right? In 2001 the U.S. economy was doing fairly well, we were in a real estate bubble, so people were paying back their mortgages or refinancing and prepaying, so the securities all looked like they were going to pay off. And that explains the circular upwards spiral that you showed on your graph earlier.

Power to the people: This wasn't a question for me, but at Wartburg we have a new program on social entrepreneurship of which I am the program director, so that is an issue that is very important to me as well. I am very much in favor of microfinance and things like that, but I do think that at the macroeconomic level if you get full employment of your resources, it is primarily a coincidence, so I think you are always going to need demand management. I think that by itself microfinance is a piece of a portfolio to return power to the people, but I think there will be trouble in the long run without some sort of Keynesian demand management.

SKYDELSKY: How do you end intellectual path dependency in economics? Well, I did make a suggestion, which was to split it up institutionally and separate micro from macro.

Soros and the mortgage system: I think that's too complex. You have to find someone, either the originator or some other institution, that holds the mortgage for some time, five years or something like that.

Rating agencies: The trouble is that they are procyclical; they underprice risk in the upturn and overprice it in the downturn. And of course it's automatic: if you are downgraded, your credit worthiness is immediately impaired, so when you actually need to increase your borrowing, let's say, you find yourself downgraded from triple A to something else. But the root of all this does lie in conflict of interest.

Expectations: Yes, I think you misunderstood what I was saying. It's not that you don't have expectations, of course you do. Think of expectations as beliefs about what's going to happen. Of course you've got those, but I am just saying they are not rational in the sense required by the rational-expectations theory. That's all. If you are afflicted by uncertainties and you want to know what to believe, the easiest thing is to ask an expert what he thinks is going to happen and then you form a sort of opinion. The only way that opinion relates to anything that is actually going to happen is that it gives you some sense of security and makes you feel that you are part of the group.

Power to the people: I would like to conclude with something I would have liked to say had I talked about "Obama's first 100 days" and about the reshaping of the world. One important requirement is to end the huge global trade imbalances which have built up between the United States and China in particular. This

requires most urgently the creation of an international reserve currency unit and penalties on persisting creditors just as Keynes devised in his Clearing Union plan in 1941. Tiny steps were made toward that at the G20 meeting by increasing the SDR facilities at the IMF. It also requires taxes or controls such as a Tobin tax on international capital movements, but perhaps even more. And if you accept those reforms, they imply a shift from export-led to domestic-led growth, and that means a slowdown in the pace of globalization. The benefits of efficient markets and efficient allocation of capital are real, but they can be purchased at too high a price in terms of democracy and social cohesion. That's part of an answer to the question about power to the people. It means they shouldn't just be clogged on globalization projects which destroy local democracy and accountability ... it's Washington Consensus. Governments shouldn't be responsible for Washington Consensus, they should each be responsible for their own people. And when the so-called efficient market hypothesis lands us in a deep slump, it's even more unacceptable. Free trade isn't God and protectionism isn't the devil. You've got to accept that there may some tradeoffs between these two concepts.

The resulting conclusion is that creating a more plural world system is part and parcel of creating a slowing down of globalization. We should begin to think of America as the fifth wheel on regional power chariots rather than the driver of each one. In any case, that reorientation, which has somehow been foreshadowed by Obama, is sensible as U.S. power wanes relative to that of Britain and Europe. A more plural political system would play its part in ending global economic imbalances since the U.S. would no longer have to please the world on borrowed money or claim the right to print dollars at will to protect freedom.