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William R. White

Speakers

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Thank you all very much for the kind words. We started this afternoon at about 1.30 and it is now 7.45. I am going to sum up in about 15 minutes. It reminds me of an American comedian from the 1960s who started his act by saying, ‘Well, we’ve only got a minute, so let’s talk about the world’. In that spirit, let us continue.

We had seven or eight sessions. Basically, it came down to three important sets of topics. The first three or four were, it seems to me, about the challenges faced for growth in the economy of the European Union. Then we had a couple of closely related sessions about the financial system – its resilience, efficiency and regulation. Then we had the last session, with Mr Da Silva talking about monetary developments globally. I would only say, without going into too much detail, that the problems in Europe resonate across the world – or perhaps the world’s problems resonate in Europe.

Let me say a few words about each of those three big packages. I would note that, in each case, we had representatives from the official side and from the industrial side. What did strike me is that there was a real dialogue, which was the purpose of the exercise. What was apparent within the dialogue, however, was that some people felt the glass was half full, and others – on the industrial side, perhaps – felt the glass was half empty. What I take away from this is, not only the importance of the dialogue, but also the fact that for many of the issues that we were discussing today, there is no right answer. You want to keep this firmly in mind: there are trade-offs all the time that thoughtful people have to try to calibrate. I repeat, there is no right answer.

Let me go to the first set of presentations, which had to do with the general economy in Europe. We started off with Governor Knot talking about the challenges facing Europe. I was struck by his opening comment, where he said, ‘The convergence machine is broken and it needs fixing.’ What people thought would happen in Europe as a result of the introduction of both the Union and the eurozone was that the slower growing countries were going to catch up. In fact, however, because of resource misallocations, what happened was that the slow countries did not catch up but went into crisis, and the fast countries slowed down. So, we have a convergence problem within Europe.

Governor Knot then went on to talk about the underlying reasons for this unwelcome outcome, and also about the associated challenges and possible policy solutions. I think the central point that he made – and this is going to lead me into the second session – is that monetary policy can only buy time. Again, this is consistent with what Mr Da Silva just said. Monetary policy can buy time but, if the underlying problem is essentially a need for debt reduction, then we have an insolvency problem. Unfortunately, while central banks can print the money to deal with an illiquidity problem, they do not have the means to resolve an insolvency problem. Monetary policy, then, can only buy time.

Then Governor Knot suggested – and this is consistent with the written material submitted to the Eurofi Magazine by Minister Schäuble – that fiscal policy also has its limits. Given these limitations, both participants arrived at the same conclusion that Mr Da Silva just finished with. We really have to think much more seriously about structural reforms.

Governor Knot finished his presentation by noting that it is one thing to conceive of a solution, but the secret of everything is implementation. You might have a good idea but you have to do it. You have to walk the walk. Here, Europe is not doing well, and I was struck by his comment that, of the post-crisis recommendations for reform, 41% have been completely ignored, and well over 50% have been only partially implemented. We have, then, some big challenges in Europe.

Then we had the second session – the one with Philippe Bordenave and me. I will be very brief about this. Whereas the earlier people had suggested that monetary policy is not the answer but can only buy time, Bordenave went one step further. He said that monetary policy has not only ceased to be the solution but is also becoming part of the problem. The point that he made is both simple and true. Loan markets do not have just a demand side, but also a supply side. If bank profits are cut enough, due to some combination of ultra-easy monetary policy and regulation, that reduction in profits will then lead to a reduction in lending. If you have a reduction in lending, then we have another problem.

In this regard, and going back to my theme about trade-offs, I was struck by Mr Hökmark's comments at the end of today's sessions. He noted that regulations are designed to produce financial stability. However, if at the same time they cut lending enough that you get no growth, then this can result in a significant increase in non-performing loans (NPLs) which can also be source of financial instability. There is, then, a kind of circle here. And again, there is no right answer. We have to have some balance in the regulations so that they directly contribute to financial stability while also allowing enough economic growth to avoid financial instability arising indirectly from another source.

Still related to challenges for the European economy, I then chaired a panel on longer-run demographic challenges. The first question is: what is the problem? As I described it during the panel, the problem is that the favourable demographic cycle that we had from 1970 through to the early part of this century is in the process of turning around. As the supply of workers declines, the result is going to be less growth, more investment, likely more inflationary pressure and higher real interest rates over time. Rising dependency ratios in Europe will create a lot of fiscal challenges for governments. People talked a bit more favourably about how rising pension obligations for governments do not look so bad in Europe, but most also agreed that the underlying problem is likely to be rising government expenditures on health care and other services for the elderly. As people get older, the costs of healthcare become greater and greater. In the end, there will be a problem finding financing for Pillar I.

Pillars II and III will also have a problem. Even if interest rates go up over time, their starting points are not good. If you calculate the numbers, it looks as if Defined Benefit plans will generally be underfunded, and that Defined Contribution plans seem unlikely to be able to provide enough for elderly people to live on. There is, then, an issue with respect to all three pillars.

Are these challenging problems well enough understood to get action to do something about them? I think the panellists felt that governments do understand, and that people like those in this room also understand. However, the man in the street does not understand and this is a problem since governments are politically constrained. If the people do not quite understand – and the people have influence, on governments through the democratic process – then the governments may understand but they cannot act. So we have a problem.

The third question, assuming you can do something about the problem, is what are the solutions to these demographic challenges? A general point is that all three Pillars have a problem. Accordingly, it would be best if all parties concerned interacted and cooperated in a way to try to solve these shared problems simultaneously. As for encouraging more saving to support post retirement living – and I will come back to this later on – I was intrigued by another implication of the general public not really seeing the magnitude of the problem. Since they do not see the need to do more saving on a voluntary basis, there may be something to be said for more mandatory savings plans. Or, if we do not wish to go that far, we may need to impose something like automatic enrolment in Pillar II, but with the option to opt out. We need more incentives, however, to do that stuff.

Longer working lives was another general suggestion for tackling the demographic challenge. Finally there was the issue of what we can do by way of innovation and increasing total factor productivity to raise output in the face of a declining labour force – again, some of the things that Mr Da Silva was just talking about. Up until now, then, lots of challenges to ensuring economic growth in Europe...

Then we went on to two other sessions that really had to do with more detailed approaches to the solutions to these problems; in particular, how best to increase savings for long-term investments, and then how best to increase investments over the longer term to match the savings. The central point to note is that, in the first instance, if you encourage more saving, this will restrict aggregate demand. We then have to have, at the same time, some measures to encourage investment to offset this tendency to weaker demand. As well, more investment implies more physical capital in the ground so that, when there are a smaller number of workers, those workers will have more capital to produce more productively. That is an important part of the longer term solution to the demographic challenge.

On the savings theme, I was most intrigued by the idea of the so-called Pan-European Personal Pension (PEPP), which would, as it were, run in a kind of parallel way to the national schemes that exist at the moment. The PEPP would provide a means for people to have much more mobility – which, of course, is becoming part of the European labour market, or should be – so that people could take their pensions with them and profit from cross-border investments in a way that they cannot do at the moment. I found that a very interesting set of discussions.

I thought that there was general agreement about the desirability of PEEPs, both among the panellists and in the documents that were circulated to you all. What I noticed as well was an insistence on the part of a number of people that, when we bring these things in, they have to be Simple, Transparent and Standardised (STD). Moreover, some even suggested that pension assets might need to be backed up by some form of government guarantee. This reflected the prevalent mood at the moment, which could be summed up as ‘I do not trust the financial system to look after my money, thank you very much.’ I thought that that was an intriguing thought as well.

Closely allied with these suggestions was an idea mentioned by a number of the panellists. When we come up with this new cross-border pension scheme within Europe, which is going to be simple, transparent and standardised, you have to use fintech and the benefits of digitalisation in order to cut costs and increase returns. A lot of money is being wasted at the moment, particularly for advice that is not really worth having.

In terms of measures to increase investment, I will be honest with you. Although I profess to being enormously talented, I still found it impossible to be in two rooms at the same time. I was in this room listening to the discussion that I have just described, but there was simultaneously another interesting discussion in the next room about the Juncker plan. Here, the only thing I will say about the Juncker plan – and this is drawn from reading the excellent documents that you should all have read carefully – is that the 'glass is half full' of the public sector and the 'glass is half empty' of the private sector was again in evidence.

What I mean by that is that the public-sector people described the Juncker plan as, basically, increasing the capacity of the European Investment Bank (EIB) to take on more risk: more equity and longer-term investments than other people. In this way, they will then be de-risking other people's investments. This is a good thing and you can lever up investment on that basis The private sector's response, however, was, in a sense, 'Not so fast, boy Robin.' What they are worried about is cherry-picking, and the possibility that public-sector people – both the EIB and the national banks – might crowd out the private sector rather than complement it. Above all, the lesson is that the public sector has to ensure that the de-risking that they anticipate for the private sector actually happens.

These were broadly the big economic challenges identified for Europe and what might be done about them.

The next two sessions had to do with the financial system, and I think I can be much briefer about that. The first session was on the resilience, efficiency and competitiveness of EU banking. I think the general point that was made – and I go back to my trade-offs again – is that the system is now more resilient but this has come with a cost. As to the former, there is more capital and there have been many steps taken to ensure that the system is more resilient and more stable in the short term. As to the latter, I will get into the question of what the cost is when I talk about this next session. The second session on the financial side s had to do with the European Commission's "Call for Evidence" on the effects of recent regulatory changes. Regulators, governments and the Commission have recognised the fact that there have been huge numbers of regulatory changes. The question raised is whether we have struck the right balance between short-term financial stability and the economic growth that you need for longer-term financial stability.

Virtually everybody on the panel, and all the papers that were distributed to you, suggested that raising this question now was really the right thing to do. These changes to the regulatory framework have been very complex, comprising reforms of banking regulation, insurance regulation and security-market regulation. It is entirely appropriate to question whether we made some errors or whether there have been are overlaps or omissions. Things are complicated and maybe things should have been done that nobody thought about, so there is a really good reason for going back and taking a look at all of this.

There was, however, an undercurrent, in both the session with Jean Lemierre and in the session about the Call for Evidence, of another kind of trade-off. On the one hand, people really wanted to identify regulatory problems that might be out there and to fix them now. On the other hand, there was a strong undercurrent of feeling that the whole financial system remained very fragile and that even relatively minor changes or fine-tuning along the way could prove to be systemically disruptive. This is an argument that fits the old English aphorism, ‘Sometimes the best is the enemy of the good.’ You might identify problems that really need to be fixed, but there was a certain hesitancy about saying ‘Get on with it’ given that there might be some fragility in the system. Again, we have a balance to be struck.

As to the regulatory changes already made, it struck me again that most of the regulators were of the view that there was really an upside to it: capital levels and leverage ratios are higher, and a lot of other forms of progress had been made. In contrast, a number of people – again, particularly on the industrial side – said that they were worried about the downside. A number of references were made to constraints on lending, going back to the suggestion earlier in the day that maybe lending had suffered because of what had taken place on the regulatory side. There were references – again, back to the second session this afternoon – to profits being under threat, not least because of the cost and complexity of compliance. There were also repeated references – and I emphasise “repeated” references – to Basel IV and the concern that, if the capital requirements were to go up significantly more in the near future, this might have bigger negative implications than one might think.

Finally, we had the last session presented by Mr Da Silva who basically put some European problems into a broader global context. At the same time, I thought he made a very convincing plea for alternative solutions to both global problems and those being faced in Europe. I will repeat and finish with this: if monetary policy is not the solution to our economic problems, what is the solution? I think the answer is for governments to do, as quickly as possible, what only governments can do.

Item number one, it is time for serious structural reforms. Second, we need much more public investment in most countries, both globally and within Europe. When you have trucks taking 300 kilometre diversions in Germany because they cannot get across unsafe bridges, we have an issue. Third, countries with fiscal room for manoeuvre should use it, dependent on how they think the markets are going to respond. Fourth, and I express this as a personal view not necessarily that of Mr Da Silva, I think we should be going back to looking at the share of factor incomes. Wage incomes have been kept, in a sense, too low for too long. You can neither consume nor save what you have not received as income in the first place. Looking at these distributional issues should also be part of the solution to Europe’s economic and financial challenges.

Finally, I think we need to reduce debts in an orderly way. This too is a personal belief since nobody said this today. To me it seems clear that, if the underlying problem is one of imprudent loans and the build-up of an excessive stock of debt, some of that debt is not going to be serviced, much less paid back. The sooner it is recognized that some debts are non-sustainable and need to be restructured, the more likely it is that you will have an orderly solution as opposed to a disorderly solution to an unsustainable situation.

Those, then, are the things that we collectively need to do. Some of those things came out of the discussions, some from Mr Da Silva’s presentation, and some from my own head. Nevertheless, I think we should be thinking seriously about such policy suggestions, both globally and in Europe. Governments, not central banks, need to get on with implementing such policies and as quickly as possible.

Acronyms:

BIS Bank for International Settlements

EIB European Investment Bank

NPL non-performing loan

PEPP Pan-European Personal Pension