

## PANEL D - GLOBAL MARKETS, GLOBAL CRISIS

Chair: Oliver Grimm, Die Presse

Panellists: Michael Landesmann, Johannes Kepler University (AT); Heinz Hauser, University of St. Gallen (CH); Subidey Togan, Bilkent University (TR), Øystein Olsen, CEO of Statistics Norway (NO)

Oliver Grimm:

Ladies and Gentlemen, warm welcome here to this actually quite brightly lit at least here on the stage it is extremely warm and well lit. Welcome to the first panel of the second leg of this symposium. My name is Oliver Grimm I am an European Affairs and Economics Journalist at the Austrian Newspaper "Die Presse" and being really frank with you, I have to urge you not to kid yourself this crisis are massive. We should not fool ourselves, the situation is grave, the crisis is deep. Just two days ago the international monetary fund stated that for the first time since the year 1945 the global economy actually shrank overall. This has in the mean time of course happened several times in different regions but not in total. Just yesterday night congressional budgetary office actually published its estimation of President Obama's proposed measures against the crisis. Actually if all these measures would go through that the president would like, the US deficit would rise to a whopping 30.1 percent of the US GDP and I am going to spare you the details of the US indepthness of the US economy and the citizens in the next couple of years. The good news is that the crisis is so deep. As you might know the word is of Greek origin and it stems from the word greneam, which mean to separate, to divide as I've learnt from a smart book that I looked into, because I didn't know that myself, 'crisis' the Greek word initially designated that point during a sickness that is decisive for the progress of the cure. So in fact very important and interesting junction right now for the European economy, for the individual European economies and I'm very delighted to present to you a very distinguished panel of experts here. That will cover actually the three countries that this Extra Europa symposium focuses on: Norway, Turkey and Switzerland, but of course also the European Union and Austrian particular. I thought that I'd introduce them to you in the order of the length of their journey here and so it's my pleasure, my privilege to start off with Prof. Subidem Togan. He teaches economics at Bilkent University in Ankara. I'm very envious that he actually

got his PHD economics at John Hopkins University, that's one of the Universities I'd actually loved to study myself at one point. His focus is international trade but also the economic transition in Turkey and I think that's a huge area of research, and of course also the economic ramifications and accessions of a possible accession of Turkey to the European Union. Just a couple of kilometres further way from Linz than Ankara is Oslo and that's where Mr. Øystein Olson comes from. He's the director general of statistics Norway. So he is the one, who is about everything you want to know about the Norwegian economy, he will have all the figures with him. He also used to be a guest at the Laurence Birki Libratory of the University of California in Berkeley and I think one of your first thoughts of career positions at the statistics office dealt with the oil and natural resources sector in Norway and of course that's quite a big issue and we will talk about this later. Closer to Linz of course is St. Gallen and that's where Prof. Heinz Hauser is from. He's a Professor for international economics and also the director of the Swiss Institute for international economics and applied economic research. You also have an international degree; you were visiting Scholar Münzdorf, Philadelphia, Barkley, Vancouver and so on. You've also taken a closer look at, that I find very interesting, the missing link for explaining you institution building and the legitimacy of your institutions. I'm afraid we won't be able to talk about this in great length but I'd be really interested in your views. And finally closest to Linz of course is Linz and that's where Prof. Michael Landesmann teaches economics at the Johannes Kepler University. He's also the scientific director of the Vienna Institute for International Economic Studies, the VIIV, if you don't know it, check out the website, that's one of the best sources for economic data in central and Eastern Europe. His scientific pedigree is really impressive and makes me very envious. He got his PHD at Oxford University, he taught at Cambridge and he was a visiting Professor in Harvard, Bombay and so forth. I think there's no University you haven't been to, or only very few I had the impression. And you were also an economic advisor to Romano Prodi during he's stint as the President of the European Commission. I'd also like to start off the initial presentations of the distinguished speakers with Prof. Togan and the floor is yours.

Prof. Togan:

Thank you Mr. Grimm. I would like to thank first the organisers for inviting to this symposium and I have enjoyed being here in Linz. It's a beautiful city that I would like to

stress. Now, what I will do is, I will briefly indicate the development in the Turkish economy and vastly I will consider the EU - Turkey relations, how the situation looks like. Now, the crises that have emerged in the developed countries has rippled across the world and Turkey has been no exception. The crisis is having major effects on the Turkish economy. Now, when considering the effects on the Turkish economy, one can summarize the effects under four headings. The slowdown in the economies of Turkey's export markets, led to sharp drops in Turkish exports and this trend is expected to continue. Development in world capital markets have reduced capital flows into Turkey, influences are expected to reduce further in 2009 depriving the economy of its primary growth engine. Consumers and firms lost confidence in the economic activity and feels of recession triggered worries about the course of events. Domestic demand decreases substantially and one final aspect I would like to emphasize is on the positive side; the easing in oil prices has vitiated the pressure on the current account: deficit.

Now, trade in the final months of 2008 and in January 2009 has promised capital inflows into Turkey have declined substantially as FDI-influence decrease. In fact during these months, inflows turned into outflows. Real sector confident index decrease substantially losing confidence affected mainly consumer spenders, furthermore credit markets tightened. Banks have been reluctant to renew credit lines and the refrain from extending new credit. Fear of recession has increased. As a result GDP has declined and unemployment in Turkey has increased. On the positive side I mentioned the decrease in the price of oil. Now, another positive aspect is related to the banks. Banks in Turkey do not feature substantial trading in instruments as a result we are not expecting the same kind of problems that were faced in the developed countries. The third aspect is consumers did not face worth affects mainly, of course of their limited exposure to equities, corporate bonds and devoted instruments. Now, public authorities responded to the crisis by following monetary and fiscal policies. In particular central bank of Turkey has decreased the benchmark interest rate considerably but the effects of monetary policy are expected to remain negligible as lower rates will not necessarily encourage Turkish banks to lend and firms to borrow. As in the industrial countries fiscal expansion is expected to play the major role. But policies associated with increasing public consumption, public investment, transfer payments and reducing taxes have to take into consideration the two types of constraint the economy faces. These are the

constraints that we call on fiscal sustainability and current account sustainability. To increase the demand for commutes in Turkey unhands GDP unemployment, public authorities need to increase the budget deficit. But this will result in higher public dept as of the end of 2008 public dept GDP ratio is about 37 per cent and the interest rate on public dept is about 15 percent. The time path of debt to GDP ratio over time will be largely determined by the value of the primary surplus to the GDP ratio. This ratio has declined from 4.6 per cent in 2006 to 3.5 per cent in 2007 and further to 1.7 in 2008. For 2009 the forecasted value of the primary surplus to GDP ratio is about 1 per cent. If the country would engage in further fiscal expansion the primary surplus to GDP ratio could decrease further to zero or could even turn to negative, leading to substantial concerns about the sustainability of fiscal policy. Competitions reviewer that physical sustainability requires a minimum value of primary surplus to GDP ratio of about 2 per cent. Now similar considerations apply also to current account sustainability. Now all this means, difficult times are awaiting the Turkish economy. During 2009 it may face tidal limits. Sudden stops may increase the pressure on exchange rate and the danger of financial destructions. The contraction in exports could continue. Policy makers will be confronted with the difficult task of designing policies that may reverse the possible decrease in GDP and increases in unemployment. But policy space is rather limited. As a result of these consideration an IMF has been involved in negotiations with Turkey. Now, turning to the role of the EU. The EU is the main trading partner of Turkey and Germany the most important trading country. Most of FDI inflows into Turkey come from the EU-countries. Since the crisis is affecting the Turkish economy, it may lead to do sharp drops in exports and reduction in external capital flows. EU could potentially assist Turkey in solving its problems, but the EU is facing problems itself. In the EU access to bank credit is highly restrained as EU seeks to reduce leverage and rebuild their capital bases. The recession arrived in Europe faster than they expected and is deeper and more widespread as was indicated before and anybody could foresee. GDP is shrinking, industrial production is decreased considerably and trade is collapsed. The situation is particularly serious in post communist Europe. When the EU tries to find European solutions to the crisis in post communist Europe, it could potentially include into such programs Ukraine or Turkey. But the chances of implementing such programs are rather dim. Now, we believe in Turkey that policy makers in the EU have to resist any cause for

increase protections, this is the major aspect I would like to stress. Markets have to remain open and parties have to avoid the use of begar by neighbour policies. And that's all, thank you.

Oliver Grimm:

Thank you for the finishing message particular I hope it's well heard in Paris, Vienna, Britain, Berlin and so forth. Mr. Olsen, your turn and I think you have a couple of - no you have them later -first lines.

Prof. Olsen:

Well, thank you chair and like my colleague and colleagues let me also thank the organising committee for inviting me here to this very interesting event discussing very important issue of our time. I'm going to take a global perspective to start out with that but of course touch upon features of the Norwegian economy, which is by the way, kind of special or has some special features. But let me start with internationally and point out globalisation, which we experienced. That has gone on since the earliest days of trade across regions and across countries. It has moved in waves supported by advents in technology and policies. The reasoned wave of globalisation is particularly strong fuelled by the integration of China, India and other emerging countries in world trade. Over time and in particular in this last period globalisation has significantly improved, standards of living raising production and incomes. I think it's very important to think of these positive sides of globalisation that we have benefited from for a number of years. These benefits can be illustrated by numbers, some numbers. Real GDP per capital in developing countries has more than doubled over the last two decades. Over the same period the share of population in the developing countries living in extreme poverty has been reduced from 40 to 20 per cent. According to the World Bank life expectancy has increased by 20 per cent over the last 20 years. While recognising these positive developments it's clear that globalisation also involves costs or at best is unable to solve some of the major challenges that we face globally. More specifically for some time it has been quite clear that there are at least two global or the outset that there are two global crisis. The food crisis and the problem that both groups of people and countries are still lacking behind and the second is the climate crisis as perhaps the broadest and most difficult of environmental problems of our time. Then at the end of last year we learned that there is a third major problem related to globalisation mainly this systemic

risk in unregulated financial markets. So we got financial crisis and by now I guess it's well known that this followed after a long strong expansion of the world economy and that during this period global imbalances were building up. Which huge saving surpluses in China and other net-exporting economies and corresponding deficits in the US and in other OSED that is most other OSED countries. Sustain low inflation and interest rates continued to stimulate demand and credit goals. Developments of due complex financial instruments were incur raged aiming diversification but at the same time blurring the over side of the inflated balance sheets and thus increasing the systemic risk. So acid prices went up strongly and investment decisions were based on expectations of continued growth. So in retrospect a classical boom and worst scenario, that's what we have experienced. A period of long growth ended up in bubbles that burst and a world economy punished into the deepest recession since the WWII and I think there are lessons to be learned from these reasoned experiences of economic fluctuations. The first is, that in financial markets there is obviously a need for reviewing regulators' regimes, both, at national and international levels. Some of the capacity or perhaps a large part of the capacity I would say in this sector, in the financial sector, has to be scaled down and a number of the complex financial instruments that were created will be or have to be abolished. In addition in the financial sector in particular, we need a trend away from excessive individualism towards greater social responsibility. Wages and schemes will have to accommodate a new culture or at least revised culture. Regarding economic policy, recent developments have demonstrated once again the difficulties that one faces in stabilising economic developments. In spite the fact that this has been a main focus of monetary policy in many countries and regions through different versions which is called inflation targeting. Still policy was not able to prevent the severe down turn in the real economy that we now face. So, I think it's correct to say that today it's rather controversial to claim that to some extend this must be regarded, or the problems must be regarded as a result of 10 years of low real interest rates. And as consequence I believe that there will be a shift in paradigm both, in economic theory and in practice so that central banks would seek to avoid similar bubbles and outcomes in the future. Now let me turn some few words about the Norwegian economy. The financial crisis is worldwide, all countries are affected. Norway as well. However the impacts for our country will probably be milder than experienced by many others. And

there are some obvious reasons. The first one is oil. Due to the large petroleum refineries we have benefited from a number of years our financial situation is more than solid. We have abandoned surpluses in government finances and thus there is significant room of manoeuvre in economic policy. Second point, Norwegian like banks in many other countries are relatively solid in relatively terms and this is due to in Norway some experiences that we had in the early 90's, 1990's where we had a number of separate Nordic banking, local banking crisis in the Nordic countries with some experiences drawn. Still in the globalized markets, capital markets that we now experience even the Norwegian banks are exposed by the global capital train and the authorities have introduced a number of measures to secure financial stability. Third point, the overall situation in the Norwegian economy is sound, unemployment is low, some would say very low it's now close to 3 per cent but it is increasing rapidly. The problems are concentrated in two major sectors, one is the export industry or the exporting industries and we are a small open economy and we will, people there will be hit by the crisis. And the second problematic sector is the construction sector where we, to some extent, had our own or a result of our own housing bubble. Given the measures taken by the Norwegian authorities and based on an assumption that the conditions in financial markets internationally gradually resume to normal conditions. Growth in our opinion will pick up according to our own estimates in 2011 - but we'll never know. Thank you chair.

Oliver Grimm:

Thank you, Mr. Olsen. Prof. Hauser, the floor is yours.

Prof. Hauser:

Thank you. I was asked to give the Swiss situation in a kind of a nutshell. Let me do so. Yes, Switzerland is also strongly hit by the international crisis, the federal government and particular national banks, Swiss national bank put together rescue package for union bank of Switzerland in the amount of about 50 billion Swiss Francs, which comes to about 35 billion Euros, which is approx. 10 per cent of our GDP. For one bank, which is substantial. We are hit at the Swiss stock market dropped substantially because it's heavy loaded with financial services enterprise. It's not only the banks but also some insurance companies Swiss Three for example. Or have a very strong exposure to the international crisis. The state secretariat of economy expects a drop of GDP for 2009 in

arrange of between 2.5 and 3 per cent, which is a quite substantial reduction in the economic output. The number of unemployed is expected to double and will reach about 200 000 next year or beginning next year. So, yes, Switzerland feels a strong impact. Second question is that due to Switzerland being outside or would it be different if Switzerland were outside the EU or inside the EU, is that question of in and out? Clearly no. The financial market it's a very clear management mistake. This one particular bank and by one or two insurance companies and EU membership would have changed anything. The drop of GDP is particularly due in there we have a little bit different situation than the other countries is due to is a very sharp decrease in exports on major markets because also Switzerland is very heavy dependent on Germany, actually no one knows, but we had very strong exports of parts for these automotive industry with a sharp production and I do not see any differences whether or not we are in the EU it is our exposure being a strongly export orientated economy to this world decline. Now, coming to the third question, how did the Swiss to all of this react? Here, I think, we have also kind of difference the fiscal policy package is low. That is due to the fact that first it is difficult to see that you can counteract an export decline by public expenditure and the local economy is still relatively strong, which is not drawn let's say great advantages, adventures and expansions. But in Switzerland the Swiss national bank has taken a much stronger part, I think, in the counter cycle measures. The Swiss national bank had been a major partner in this rescue package because without going to detail basically they bought out that from the union bank of Switzerland and put it into a separated legal entity which was financed by a credit by the Swiss national bank. So the Swiss national bank basically takes the risk on this about 50 billion Swiss franc of bad papers in this legal entity. Circumventing our action, circumventing the public budget of course because the parliament had nothing to say, because it was in a digression of the Swiss national bank which is somewhat doubtful with a let's say decision making, because politicians were left out of the picture, but on the other hand allowed to act very efficiently in time and without large noise. Was much easier I think, to just put together a rescue package in due time. But it's also, it's even more so, the Swiss national bank has started to really follow a policy of cheap money and actually only recently it started to buy up corporate bonds and lowered interest rates and tries to depress the exchange rate because the Swiss franc appreciated over certain time, period of time, is now

depreciating. Here the question is more open: Would it make a difference? My feeling is, it does. Because, well I have not gone into very strong details, but my feeling is not, it - let's say, if Switzerland were in the EU it would be part of Euro zone and I don't think that as a national entity of the European central bank you could use the same power as the Swiss national did in these last months. So I think there we have an additional policy space compared to being part of the EU. Lastly, yes we are also indirectly hit because, it's my strong feeling, that the financial crisis has strengthened the power of governments like Germany, France and others, United States, Great Britain to have a very strong move against bank secrecy laws. And bank secrecy law is a very strong part of Swiss banking. Would it make a difference being inside, outside? I don't think so. Austria is in the same situation. I think here we just see in crisis power rules over agreements. I think both, in principle, would be protected by agreements against this pressure. Austria would be protected by agreements against its pressure but in crisis time power overwrites this kind of agreements, I think, there I don't see really great difference being inside, being outside. So finally coming back, to sum up. Switzerland is hard hit. I think it has kept somewhat great of policy space in monetary policy compared to EU members so in the end my evaluation would be rather, I think it is an advantage being outside, but that might depend on the fact that the Swiss economy is a strong economy we have a sound fiscal position, we have a strong currency and we have a strong capital count.

Oliver Grimm:

Thank you. I think if a central bank can push a 50 billion Euro Francs rescue package past the parliament of one of the most fiercely democratic societies in the world you really realize how deep the mess is that we are all stuck in. Prof. Landesmann do you have something to cheer us up?

Prof. Landesmann:

(Laughs) Yes, probably at the very beginning. Well you heard three very authoritative statements so let me start from the other side. I remember in 1989 there was, is it? (Moderator: I think it is.) In 1989 there was a very nice caricature in one of the British newspapers, "The Guardian", where Marx was sitting on a big desk furiously working on mathematical formulary with lots of piles of paper being thrown and so on. And underneath was saying: "I must have made a mistake somewhere."- yeah, when the iron

curtain fell. And of course this issue applies also to probably one imagine a similar picture now with (Allan Greenspan), many other people involved in the financial markets, economics in financial departments etc. Similarity standing now probably not right scribbling down, but in front of their sufficient computers and seeing their models really feeling to understand and predict what was going on. So I think apart from these authoritative presentations we might be able present, one shouldn't forget that there was a huge intellectual failure also in advance of that crisis. And I think we as economics should also take some of the blame, not only us as economics of course there were issues of political economy there were interest groups who were pushing towards certain developments, but there was also a major failure of understanding the extent of what was going on. Now of course all sorts of economics would say "oh I've said this and this", but it was not massively said and it was only very partially said. We had some macro-economists who pointed out to some major equilibrium problems. But to the degree to which we have witnessed a huge, what economists call a contagious effect, across the world with no part of the planets paired of an amazing contraction process which we are witnessing now. I think the extend of this unfolding off a crisis was not predicted and I think it was probably partly not predicted because the real world understanding of how financial markets worked in a general room setting not only in a partial setting were not fully taken on board. There was probably too much innovation to follow what was going on and the repercussions between the financial markets and the macro-economic circumstances was also not. Now of course one finds pieces of theoretical tools which can all make sense of that but I don't think the picture was put together. So at the moment we are now stuck with the situation which is, has some similarity with previous historical periods but also has a lot of innovatory features and I think we should not again present the picture as if we know sufficiently what the at least medium run pattern of development will be. And also how the policies which have been implemented the size of the policies package is, and really going to operate on the economic systems. We hope they have particular implications which will counteract the recessionary and repressory processes but we don't know the degree to which. Because I think there's a system of a more or less complete breakdown of financial markets in their functioning, in relation to real economy requirements. That type of element has not been witnessed for a long time and of course some of my pre-speakers

said, the degree of internationalization/globalization is extremely high and therefore the interaction effects are very strong. So probably now I should use my remaining time for drawing a bit of my relative expertise or comparative advantage compared to other speakers and that is basically the development in central Eastern Europe. I think this intellectual failure also includes not taking into account a degree to which the international economic crisis would spill over into central Eastern Europe and therefore this is of course quite important for the Austrian economy which has developed a very strong exposure in trade and foreign investment and of course also in banking involvement in central and Eastern Europe. So this area is of importance, not only for the countries themselves, but also for the Austrian economy. I think in many ways there are similarities between what Prof. Togan was saying about the Turkish economy because these countries were major successors over the last 6, 7 years. Just as Turkey was a major successor over the last 6, 7 years with high growth. It was really now more or less textbook growth models put into operation catching up from a low income level and drawing on the amazing possibilities which a globalised world allows of catching up. Namely technology transfers, strong access to foreign investment, the rather quick ability to learn from practises abroad, the ability to draw on capital, know how to use finance, etc. So I think, basically we were witnessing a period of rather interesting and relatively indifferent growth. Almost the whole central Eastern European economy, just like Turkey as well, grew in the range of between 5 and up to 10 per cent per annum over a rather sustain period of at least 5, 6 years. Now this growth experience has come to a sharp end now and probably I should mention, I think we probably all agree what is behind it. One is the sharp decline of export markets in countries which have become very open and rather successful some of them in exporting to western Europe. More successful than we predicted in the 90's. This export markets have declined, there's an enormous caution to continue the model of external finance being provided to support investment processes and also to a high degree of the consumption processes in these countries, which is in an normal environment quite natural because capital should flow from rich countries to poor countries to support investment processes there and in fact with these high grow rates it would be a good business because you expect high growth yielding high returns. So there is both, real reason and incentive for this capital flows. Now of course in some countries we saw

danger zones being crossed and there it's an interesting constellation which also shows the problem of getting out of the crisis for some of the countries. Because many of the countries were very keen on monitoring stability, so quite a few countries tried to maintain a rather strong fix or fixed link with Euro zone. Some of them had completely fixed exchange rate regimes. So in fact they gave up to some extent their ability to influence, when a shock takes place their ability to counteract it with exchange rate flexibility. So, and of course in the circumstances before everybody expected basically a trend appreciation of these currencies which actually also took place. So in many ways the imagination of financiers from outside the region was such that there is no real currency risk and therefore they were very willing to lend money. If at all there was a risk, it is more in the direction of an appreciation rather than a depreciation. So the countries had a trend increasing exchange rates also Turkey after the major crisis and that is an additional incentive to lend money. So you started to feel in some countries quite too much exposure to foreign lending ballooning especially in those countries which had absolutely fixed currency regimes like Bulgaria or the Baltic countries. They started off current account deficits meaning a difference between exports and imports. Importing much more than the export of 25 per cent of GDP per year meaning you accumulate falling debt by 25 per cent per year over last 3, 4 years in some of these countries, which was stimulated by the rest of the world that has no currency risk. So now we are, once the financial markets changing behaviour, there is, I think again Prof. Togan mentioned it, economics called it a sudden stop meaning it's not necessarily completely zero but a dramatic decline of the willingness of the rest of the world to continue financing current account deficits. So basically we have to bring exports and imports in line with each other and there are only variables which can do that: either you have a dramatic decline of economic activity, which means that people with fall a very much lower will income they can, they import less. So that shows for example in the Baltics a move from sometimes plus 10 per cent growth in the previous year to minus 10 per cent in the current year which actually is one way of balancing this in equality of exports and imports. The other variable would be a real exchange rate depreciation meaning that your money becomes less worth compared to the trading partners. So you can't afford because it's too expensive to import. So one is a price variable and the other one is real economic activity. And in fact this second variable moved dramatically in many

countries, I mean on average we had decline of about 25, 30 per cent in real currencies and in countries like Ukraine you had from the peak of 60 per cent a depreciation of the currency. And I think Turkey also had it in region of about 25 per cent, 'is it right'? (Prof. Togan: Yes, that's right.) So I think this mechanism of bringing export account into balance worked in those countries where it was possible via a dramatic change in depreciation and in, well, this is an mechanism which should be welcomed because it probably is going to have less effect on real economic activity than the direct trying to maintain a stable currency and just using the economic activity level. But of course it has further very problematically repercussions and it's known from the newspapers that many of this loans were of course in foreign currency because, again Prof. Togan mentioned it, 50 percent interest rate in Turkey so why should one borrow on the domestic market if you can borrow it for much lower interest rates from abroad which were. So I think there was a very strong incentive to indebt yourself in foreign currency once the exchange rate declines dramatically your debt becomes immediately 25, 30, 60 per cent higher because of this revaluation of your income in comparison to foreign income to what you have to repay to the people you owe money to. So these countries now face huge problems to repay debt and that includes, it's mostly private debt it's quite interesting that except for Hungary almost all countries have very low public debt. In fact, Prof. Togan mentioned, 37 per cent public debt in most western European countries would be very happy with the public debt level of 37 per cent in GDP. But in fact this is quite typical in most of these countries you have 25 to 40 per cent public debt so in principal there would be quite a bit room of manoeuvre to increase public debt. But so the private debt is the serious issue and of course from a western bankers' point of view the worry about re-adjustment means that less of this debt will be able to be repaid and therefore the repercussion on the western banks balance sheets which we are worried of course in Austria and quite a few other countries. So that is one group of countries, other groups of countries, I think, are even in a worse situation. Namely the once who have packed the currency, because so far they have only been able to counteract this crisis by a reduction of activity levels, they didn't have the possibility of revaluing their currency. Some of them added a way of dramatic declines in wages and salaries which were one of keeping some cost competitiveness or depreciation like the Baltics have made an adjustment in public sector and pays of minus 25 per cent and so on. But in

many countries you don't have flexibility of balancing through the real exchange rate, especially in periods where the rest of the world has moved towards more or less zero inflation or one per cent inflation. So the possibility of actually adjusting through low inflation rates is very low and therefore these countries are going to face this problem of sustainability immediately because they have no mechanism to adjust their current account imbalances unless they stay on an absolute contractionary or stagnationary level.

Oliver Grimm:

May I just cut in here because we only have some twenty five minutes and we should keep the discussion moving (Prof. Landesmann: Yes, I'm sorry about that.). I take as an issue that of course a huge problem of reaping these debts and we are going to see a lot of dumping and rebalancing in the next, still some more rebalancing within the next months and probably yes. Prof. Hauser, I'd like to turn to you, I've actually tried to sort of ask you things about the state of the Swiss economy without mentioning the word 'bank secrecy' so you've actually done it and I have done it, so the thing is, out in the open, how serious are the recent developments that we see the pressure from the side of the US, the US attorney and the security exchange commissions, commission, the pressure from the EU. How gravely will this affect the overall economy of Switzerland, because I think financial services are about 13 per cent of your GDP so that's a massive chunk of your economy.

Prof. Hauser:

Well, I think the truth is, that no one really knows. And I've not heard even any good guess whether this change in ... because we agree to the same changes as Austria did, that Swiss government will exchange information on demand also for taxation and not only for tax-fault as it was in the past. So basically it's really massive in let's say, international cooperation for tax but the real question then comes, while first it's clear we have enormous amount of money being invested or being managed by Swiss banks and really I think, it's more than 50 per cent of total private wealth which is managed in Switzerland. But then the question isn't there no one can give you a precise answer because secrecy also means no information. How much of this money is in Switzerland because of the taxation reasons or another reasons? How the investors react? Might even be that you know in the worst case, even investors from countries who do not ask

Switzerland for changing the bank secrecy law - flow of information. They may just think, well that it is become insecure. I don't know whether I should change but on the other hand what is part for Switzerland, speaks for Switzerland there are not many places left where these investors can go. Hopefully that general alliences will be taken under control by the British but maybe it's also power game. It's not the question being member of the EU but it's a question of being protected by a strong power in the EU. So Hong Kong has changed, Singapore has changed also. Let's make this story short – I don't know.

Oliver Grimm:

And I think in any case UBS has already offices in Singapore and Hong Kong.

Prof. Hauser:

But Singapore and Hong Kong have changed too . They have the same change in laws so no one knows. I think it's not a question, but let me ask in this way: You can look at it let's say bold economic rationality point of view - what does it bring? On the other hand, I have to admit, it's very difficult to defend ethically that you make money from tax fraud. But actually before the Swiss government changed its policy it stands, I think the business model for the Swiss financing industry is not treated up to a long term trends . I don't think that you can keep a business model which relies on managing wealth which basically comes via taxation and you have to change your business model and as soon they do it, I think the better.

Oliver Grimm:

I see. Thank you. I think you are not alone with that assumption. People in Berlin see it very similarly, I think.

Prof. Hauser:

Well, that's a different story. (laughs)

Oliver Grimm:

Prof. Togan you mentioned the close economic relationship between the European Union economies and the Turkish one. So on this note I have a short, a very short quiz question to you. This is a quote from somebody who actually said that. And he said that: "What is more natural than Europe and Turkey identifying with each other in their actions and reactions? Militarily, politically and economically." Do you have any clue who might

have said that? And it's a very mean questions because..

Prof. Togan:

Yes, I really don't know who has said it. Is it from the Turkish side or?

Oliver Grimm:

No, actually not, you would never have guessed, it's actually a quote something that Walter Hallstein said. He was the president of the European Commission and he said that on 12th of September 1963, the day that the European Community signed their association agreement with Turkey and I think that the interesting thing is that Mr. Hallstein was a very distinguished member of the Christian democratic party in Germany, I think that is something the Conservatives should probably there remind that Turkey political attitude. But what I want to know against this backdrop and also against the backdrop of the crisis do you think that the things that are happening economically now and socially in Europe and Turkey, do you think this is going to have accelerating or sorts of a decelerating effect on the political integration between Turkey and Europe, because we are already integrated in of course the costumes union and we are having negotiations about the accession. Which effect, do you think, is this going to have?

Prof. Togan:

I would like to give an indirect answer to this. I was listening to the Swiss experience and I was thinking Turkey should have done the same. In the past it should have done. Right know we are stuck with a large form that 34 per cent as I said the domestic debt is low but part of it is in foreign assets and when the exchange rate depreciates, the share will also go up so the only way is to be strong on the fiscal side. I was really pleased to hear what the Swiss have done so I hope in the future we shall learn also and do also similar and try to follow similar policies rather than taking it. This time it's different, I mean, we are making, as it was mentioned before, we have high growth rates it will carry on flowing for ever that was the attitude of the Turkish side and now it has stopped. So it's an indirect kind of answer but I mean it has, it is all based on the Turkish side, there is nothing that the EU can do. What they can do is give advice from time to time. So, I mean, saying that exchange rate policy is important, they should mention that, they could mention that the real exchange rate is an important aspect. Which was not mentioned by the IMF, which was not mentioned by the EU, so Turkey's side took it for granted that would carry on forever and now it looks like it will have major problems in

Turkey. So that's an indirect way of an answer to the Swiss experience.

Oliver Grimm:

Okay, so it could be a catalyst maybe to the negotiations between, in whatever direction.

Prof. Togan:

I mean the way I see it is Turkey can ask for funds, but EU cannot provide funds since the EU is in trouble itself. So asking for funds, financial help would probably not be feasible getting the financial help and so at the end we shall experience some depression and afterwards we shall hopefully learn that the right policies are in fact the fiscal prudent, fiscal policies and so on. And real exchange rate is an important aspect, so we have been following rather not the depreciation real exchange rate but rather appreciation of the real exchange rate and that's what the policy pursued by the government. It has nothing to do with the EU-Turkish relations. It all depends on the Turkish side, that's the feeling I have.

Oliver Grimm:

I see. Thank you. We are running into the last 15 minutes of this discussion and I have to follow a very strict time schedule so my direct question to you Mr. Olsen. Before this thing has started we sat together and you said that actually the climate crisis and the global warming is something that you think doesn't really get enough attention. So what does an oil and gas producing country like Norway think about this thing? How do you deal with this? You are Scandinavian so you must be very green in my view but also in the same time you've got the oil.

Prof. Olsen:

Yes, Norway benefits from oil. But we are all in the same boat regarding climate change. All nations. And Norwegians are also engaged in contributing to solving this problem. Also as an economist I think there's a link between climate crisis and the financial crisis. Of course because everything hangs together. But also there are some basic questions that have to be addressed when we are discussing solutions. And I fully agree, let me say that with Dr. Landesmann in this lesson on behalf of economic profession. We learned about markets in our master studies, we learned a lot about markets are not perfect. There are a number of imperfections in markets but somehow I think we have forgot that on our way the last years. And as a economist, you can have my slides now it

would help.

Oliver Grimm:

Very quickly because it's 12 and a half minutes I see and we still probably have some questions from the audience.

Prof. Olsen:

Okay, I'll try to be quick. There are some, there are two fundamental questions when we are discussing the climate change problem I think. And the first, there is some similarity between the climate crisis and the financial crisis that is our market instrument sufficient to hatched about this catastrophic event. As an economist I would say yes, to start out with that. We have to rely on market instruments but then they are not perfect and we have to realise that. Just as a link to the financial crisis presently, the crisis of quotas, permits in trade system like the one that is established in the EU are very low. They have been depressed by the low activity. They give the wrong signals for long determent investments regarding what is needed to combat the climate crisis. So that's the one question. The other one is even more fundamental, I think. Can estimation of global emission be combined with growth in developing countries? Continuous growth. I think that's the major dilemma. And I have some slides illustrating that, based on official UN an IPCC estimates, on population growth to the right, CO<sub>2</sub> emission per inhabitant to the left and if we combine those we have a business as usual scenario: what will happen with global emissions in the world? Just as a result of population growth in developing countries. And the concentration of gases will come like this and the temperature is assessed, not by me, but by IPCC, will increase by, in the range 3.5 degrees Celsius in the next hundred years. So that's the outset. What will, how can it be solved? Let's assume very optimistically that we can bring ten cities of emissions and energy use in industrialist countries close to zero. And what happens then? The answer is very little. We have to make, we have to bring the developing countries along the same pattern. They have to reduce their intensities of emissions and energy use per inhabitant as well. Only then we are able to stabilize concentration and temperature. Obviously very demanding because how can that be achieved or combined with continued growth in poor countries? So that's the lesson the relatively pessimists lesson I have perhaps present for you and my conclusion is actually that we have to do our best through market instruments and in other ways but we have prepare for adaptation to a warmer

climate. Thank you, chair.

Oliver Grimm:

Thank you. That's a very good point actually particularly given that, I think, the five biggest cities will going to be affected by rising sea levels are within Asia and that's about half the population that's going to be affected, half of the global human population. We still have 7 and a half minutes. I have to be very dictatorial and I have to now pass the microphone to you. Are there questions? And if, there is one question, could you, there's a colleague of mine with a microphone and if you just go ahead.

Male form the audience#1:

My name is René Schwok from Geneva trying to raise a question link to Norway, Switzerland and Turkey. Actually the question is more to Mr. Togan from Turkey. Turkey has a customs union with European Union, Norway and Switzerland don't have a customs union with the European Union. I see one advantage of not having a customs union. Switzerland, Norway are now negotiating free trade agreements with Japan, with India, with very important Asian countries and Turkey cannot do that because there is that customs union. So my question is the following: Wasn't it a mistake in the Mid-90's in the part of Turkey to have a customs union and not simply a free trade agreement with the European Union?

Oliver Grimm:

Thank you, good question. Your answer.

Prof. Togan:

It's a very good question. I mean, thinking about it, at that time it was the appropriate policy from the point of view of Turkey to have the customs union. At that time the prospects looked good in the sense that customs union would lead eventually to a membership in the Union. Now the prospects are not that good. Thinking back, wouldn't be appropriate but what we consider in Turkey is the following: We say from the costumes union that we have with the EU, we have developed the institutions partially, not all of them. Developed the institutions that are, that form the basis for the market economy. These institutions were lacking in Turkey. Now it has the advantage, I mean we have by now quite a few of them, but we still have to develop further the institutions and this can still be achieved through the association process and it could still be

achieved through a free trade agreement. So if you look at the free trade agreement that the EU has signed with Chile and with some other countries, it is possible to have the institutions and have a functioning market economy and this is also what we would like to have. And once we have the institutions that are necessary to develop the market economy than we hope that the growth rate will be higher in the future and we shall be benefitting. So the answer to your question is, not in the past, it was not a mistake but in the future we may think about it.

Oliver Grimm:

Thank you. Further questions? Please.

Female speaker from the audience#2:

My name is (Beatrice Bulengua) from the Swiss embassy in Vienna. Prof. Hauser mentioned that Switzerland benefited from being outside the EU in terms of monetary policy. My question is to what extent do the countries outside the EU benefit from fiscal policy measures adopted within the European Union?

Prof. Hauser:

There is a, actually it's a general phenomenon that in an interlinked world, I think, if you stimulate demand by fiscal policies at least half of the stimulates growth outside and other countries profit. And it's a typical coordination problem and that's particularly typical coordination problem between large countries. I think, it does make good senses that United States, EU, Japan, these large economies take a somewhat coordinate approach to fiscal stimulate packages because otherwise only one country would pay other cost and the others would profit from these different stimulate packages. Now come back to Switzerland, it's clear if Switzerland would profit from stimulate packages but on the other, I think reverse the Swiss economy is so small compared to the rest of Europe that the impact would be smaller than other countries. But maybe could add one point' I'd like to bring into this discussion: we take it for granted at least in public debate that more is better. The higher the fiscal package, the better. The quicker the stimulate package, the better. But that might be true for the short term impact on employment but I think we have to balance short term gains from these huge fiscal packages with long term risks of these rescue packages and personally I'm much, I'm doubtful whether this short term gains are really higher than the long term risks. Because we are running in unsustainable fiscal positions in United States, Germany, in Great Britain, in Japan, all

the big powers, I have, Germany, I have no idea how United States will come back with estate fiscal position.

Oliver Grimm:

Inflation.

Prof. Hauser:

That's right. The only thing is inflation. And there is an enormous, I think, inflation risk, a worldwide inflation risk. And that the long term cost might be substantial or it would differently it's also, what we call more hazard issue. Let's take this rescue, well this fund which has been decided yesterday by EU council or Eastern European countries, central European countries. That's on the first side it is fine but actually it profits Austrian banks maybe also these countries. But you sanction unsound behaviour also private behaviour. There is a large number of private households who took credits in Swiss francs by the Austrian banks and it is that the issue why Austrian banks risking losing money but actually taking Swiss franc credits on a mortgage on your house in Rumania, or Bulgaria or in Hungary or Poland is a risky behaviour of private individuals and shouldn't have happened at all, I think.

Oliver Grimm:

Prof. Landesmann your final remark now for this session because I have to conclude afterwards. You wanted to..

Prof. Landesmann:

Yes, just on, well I think you will probably see that there's a differentiation of opinion also in the current crisis.

Prof. Hauser:

That's right.

Prof. Landesmann:

Because basically the fiscal debt implications, we don't know what is debt when you do a fiscal stimulus which, if it works keeps the levels of GDPs higher and therefore you might keep taxes base more intact as against them all as opposed to a more cautious attitude which might mean that the countries move into a much deeper recession and therefore the fiscal deficit can achieve even higher levels. So I think how to work out this balance between, it's not automatically so, that the high fiscal stimulus now leads to a

greater debt problem than a lower fiscal stimulus package now because the fiscal deficits are going to balloon also in a period recession if we don't dismantle all our social wealthier systems in Europe. And on the same issue applies on this rescue package to Eastern Europe, I should remember that this is a package to mostly designed to stabilise currency actually and the big danger is now this run and overshooting of exchange rate movements in these countries and the collapse of fix exchange rate regimes in quite a few countries which again have contagious we cannot yet calculate threw, I'm very worrying. Because it basically means, while an adjustment of exchange rate by 25 per cent might be very acceptable a fear of collapse of these rates means everybody wants to be first so it's likely to lead dramatic overshooting of exchange rates which leads to even more bankruptcies even more declining real activity and of course countries like Austria, Germany and so on which export quite a lot in this countries, a lot of firms operating these countries and in linked with their own production networks are very fearful of a very sharp contraction in this economy. So it's the same issue about you want to prevent the dramatic fall in level of activity which might cost something but might cost less than waiting for a dramatic collapse if there are these further contagion collapsing effects which would happen. So I think it's a good investment this 50 billion and it's actually not money spend, it's actually loan of course. All these things are loans, they come into operation of course only if there is default but of course the whole intention is there will be less default because the currencies are kept at a higher level.

Oliver Grimm:

And I've just seen the imposing grey shock of her of my appreciated colleague Obmann Hadinski from "Profil" magazine entered the room which reminds me of the fact that I have to close this session now. As he's going to dance you through the next panel that starts at 11.30 and is going to a close look at threads and challenges to European security in the 21<sup>st</sup> century. I have the suspicion that there's going to be some talk about probably climate inflicted risks and challenges in the security setup. I'd like to thank my appreciated members of the panel. I'd like to thank you for your interest and now please go out, get some fresh air, smoke a cigarette, have some coffees, stretch your legs but be back on time in 11 and a half minutes. Thank you.