THE BROOKINGS INSTITUTION

FALK AUDITORIUM

TIME FOR A VISIBLE HAND:

LESSONS FROM THE 2008 WORLD FINANCIAL CRISIS

Washington, D.C.

Wednesday, March 31, 2010

PARTICIPANTS:

Introduction and Moderator:

KEMAL DERVIŞ
Vice President and Director
Global Economy and Development
The Brookings Institution

Featured Speakers:

STEPHANY GRIFFITH-JONES
Financial Markets Director
Initiative for Policy Dialogue

GERARD CAPRIO
Professor of Economics and Chair of the Center
For Development Economics
Williams College

JOSÉ ANTONIO OCAMPO
Professor, School of International and Public
Affairs, Columbia University
Co-President, Initiative for Policy Dialogue
Senior External Advisor, Corporacion Andina de
Fomento

Commentator:

OTAVIANO CANUTO
Vice President and Head of Network
Poverty Reduction and Economics Management
The World Bank

* * * * *

PROCEEDINGS

MR. DERVIŞ: Good morning, everyone. Thank you for joining us, and thank you for taking advantage of the first really nice spring day only in the afternoon, not in the morning. It's one of those dangers, but it is a gorgeous day, and we're very happy to welcome our guests today: Professor José Antonio Ocampo, Professor Stephany Griffith-Jones, Professor Gerard Caprio, and Otaviano Canuto from the World Bank.

On a topic that keeps its importance, the massive crisis may be over, but we're dealing with all kinds of after-effects, but not least, of course, the fiscal issues, but also the whole, you know, the whole point that there was a huge, massive response which I believe in a way worked. But if it happens again, the space, the fiscal space, the political space, won't be there anymore. So I think taking precautions and trying to build a system where at least something close to this won't happen again is absolutely crucial. Something will happen in the future, of course. In history, you know, the end of history is not there in the sense that we can ban crises forever. But, hopefully, this type of crisis we can avoid.

So let me briefly say a few words about the panel. I'm very excited. They're one -- it's really a panel on that topic we couldn't have dreamed of a better one. Professor José Antonio Ocampo is now professor at SIPA at Columbia and a fellow of the Committee on Global Thought at Columbia University. He is an ongoing member of the UN Commission of Experts on Reforms of the International Monetary and Financial System.

Prior to his appointment, we were colleagues at the UN. He served as head of DESA, the Department of Economic and Social Affairs. He also was head of ECLAC, as you know the Economic Commission for Latin America and the Caribbean. He was minister of finance and public credit in his own country, in Colombia, chairman of the board of Banco de la Republica, director of the National Planning Department, minister of agriculture and rural development, and other things which I won't continue to mention in the interest of time.

He's a good friend, and we taught a course together at SIPA in the fall, which I really thoroughly enjoyed.

Professor Stephany Griffith-Jones is financial markets director at the Initiative for Policy Dialogue at Columbia University. She's a member of the Warwick Commission on Financial Regulation. Prior to joining IPD, she was a professorial fellow at the Institute of Development Studies in Sussex and served as a senior official, also, in ECLAC, and head of international finance at the Commonwealth Secretariat.

She's a prolific writer, as is, of course, José Antonio, and a good friend, and has really given a lot of attention and a lot of careful work that she did on the whole issue of the international financial system, emerging markets, and the reforms in that area.

Gerard Caprio is professor of economics at Williams College and chair of the Center for Development Economics there. He was director for policy in the World Bank's Financial Sector Vice-Presidency, and head of the Financial Sector Research Team in the Bank's Development Research Group.

Earlier positions have included vice president and head of global economics at J.P. Morgan, and economist at the Federal Reserve Board and the IMF. He has taught at Trinity College, Dublin, and at George Washington University. He is co-editor of the Journal of Financial Stability, editor of the forthcoming Online Encyclopedia of Financial Globalization -- and I look forward to that Encyclopedia of Financial Globalization -- and fellow of the Center for Applied Macroeconomic Analysis and Macroeconomic Program.

Finally, we have Otaviano Canuto, who is vice president and head of the Poverty Reduction and Economic Management, PREM, Worldwide Network at the World Bank. I think it's the best job at the World Bank.

MR. CANUTO: Yes.

MR. DERVIŞ: I had it for a while.

MR. CANUTO: Particularly because I inherited it from very good people before me, who preceded me.

MR. DERVIŞ: Well, it's really the economists' network at the Bank, and it's, you know, about 700 economists work on various -- all aspects of policy poverty reduction. And before he took up his position in May 2009, after serving as the vice president at the Inter-American Development for Country Policy, he provided strategic leadership and direction on economic policy formulation in the area of growth and poverty, debt, trade, gender and public sector management at that -- also at the Inter-American Development Bank.

He is involved in managing the Bank's overall interactions with key partners, including the IMF, the OECD, the regional banks and many other institutions. PREM is the network that also deals with the substantive partnerships and working relationships that the World Bank has with other institutions, of course, including the UN system.

So thank you very much for being here. And I will intervene later by asking questions, but we still start with Stephany Griffith-Jones, who will launch the book. Five minutes each, then Professor Caprio, then Professor Ocampo, and then finally Mr. Canuto will close, and then we'll turn to the discussion.

Stephany?

MS. GRIFFITH-JONES: Well, thank you very much, and thanks, Kemal, so much for hosting this. I wanted to start by pointing out that in a way the broad theme of the book is that we need a financial sector that serves the real economy. As our co-author Joe Stiglitz keeps stressing, the financial sector should really be a means to an end, not an end in itself. And what the last crisis has shown, as have the many preceding crises that have been so frequent -- some underdeveloped, but also many in the developing world -- is that they have as a main reason excessive financial liberalization not accompanied by sufficient regulation. And indeed where regulation has occurred, it has been often inappropriate. And this is now very broadly accepted, I think rhetorically, in official circles, and there is a strong commitment to have effective regulation.

But the key question to ask is whether enough will in practice be done, and the question is to make crises like the one that has recently happened less likely. Will it be sufficient, and will it be sufficient at a national level, and it will be properly coordinated internationally? And I think this is also a valid perspective, we believe, even from the perspective of the financial sector itself, because actually a well-regulated financial sector is in the interest of the individual financial actors and of the financial system itself, though they sometimes don't see it. But I think this is a key point.

So we have focused on two principles which actually are broadly now accepted, at least in the speeches. And the first one, and I think of particular relevance in this country, actually, is comprehensiveness; that we need comprehensive regulation both nationally and internationally, and by this both comprehensiveness, first of all, in transparency, which is a really crucial precondition for any proper regulation, and also in regulation itself. And what a number of the authors in the book believe, and particularly in the paper that we did with Jane D'Arista, is that we need equivalent regulation across the whole financial sector, both as solvency and liquidity of all activities, all markets, and all institutions.

And this is not because we are kind of Stalinist regulators, but because it has become so evident that if you regulate less or more leniently any particular instrument or sector, immediately you have regulatory arbitrage. And that particular less-regulated or non-regulated sector is going to grow much more and is going to create more systemic risk.

And, for example, and particularly in the U.S., but also in the U.K., there is always what has been called "the shadow banking system," which meant that about 25 percent of total assets in the financial sector were in traditional commercial banks, which were the only ones that were regulated. And even they were not properly regulated because, for example, there was a lot of stuff that was allowed to be off balance sheets which was not regulated.

So what we think as an ideal, and this is also what is in all the G-20 and Financial Stability Board statements and so on statements, is that you should have equivalent regulation in all activities and sectors and comprehensive. I think what is positive, looking at what is actually happening, is that in the U.S. legislation which is, for example, now in the Senate, there's an idea, for example, to limit for counterparty risk reasons how much you can lend to any actor, how much a bank can lend to any actor whether it's a bank or a nonbank or even a nonfinancial. And that is already an improvement because in the past it was just for banks.

Also in the U.S., we think that it's very important the attempt to bring all derivatives or most of the derivatives on the exchanges, both to provide necessary transparency, but also to provide a basis for meaningful regulation of things like margins.

But in other areas we fear that the U.S. may not go far enough because, for example, in Europe, there's much more interest to regulate hedge funds, particularly in the European parliament, although that is making slow progress, because we think that actors like hedge funds need to be also regulated in a way consistent with banks.

Finally, on this issue of comprehensiveness, there is the whole issue of international coordination, because governments are very unwilling to give up sovereignty on financial regulation. But whereas markets are global, then you need some kind of global regulation or at least global coordination because, again, if not, you will have regulatory arbitrage.

The number of interesting issues around enforcement of international regulation is that there is no time. I just want to talk now about the second broad principle that we have emphasized thereof, which is countercyclicality, or macro-prudential as its call more frequently in the U.S. And if we start from the position that the main market failure in financial markets is their boom-bust behavior, they're much better allocating at a micro level.

If the main market failure is a boom-bust, we have to have as a main feature of regulation that it leans against the wind that is that in good times when excessive lending tends to take place. So excessive investment cushions are developed either through provisions or through higher capital, also higher liquidity requirements, or through all those tools to strengthen the bank in the good times to be able to cope and maintain lending in bad times.

And this is not just an academic proposition, although we have been arguing for this, and especially José Antonio, for over decades, but it's actually been implemented. The Spanish government, the Spanish Central Bank implements countercyclical dynamic provisions, and they have worked quite well, particularly in strengthening the banks. A yearly countercyclical regulation complementing countercyclical and monetary policy would also curb excessive lending in the good time and encourage it in the bad time.

And it's interesting because this principle is now very broadly accepted in international bodies, like Financial Stability Board, is very widely discussed in Europe, but far less so in the United States. It's not a big theme here, although the U.S. Treasury Report on Regulation last year did mention macro-prudential. And we believe that this should apply both to solvency and to liquidity and, as I said, to banks and nonbanks, and also, perhaps, on instruments like margins and derivatives so that if there's an explosion of derivatives, a build-up of systemic risk, it would have to be curbed by higher margins. And what occurs, of course, in practice is when things are going very well, margins actually go down.

There is a related but interesting issue that is raised by one of the other papers of the book by Avinash Persaud, which argues that not only that when you -- you should be consistent across the board in regulating, but that those financial institutions that have shorter-term funding and that have particularly mismatches between their funding and their lending, between their assets and their liabilities, should be forced to hold higher capital charges, and that that should protect them against liquidity risks -- help protect them -- but also it should encourage them to have less of these mismatches. And I think this would be very, very useful, and this is a new idea which I think needs more development.

I would just like to finish by saying that what we really ideally want is a financial sector which is less likely, as our chair rightly said, to lead to crisis, but also a financial sector which funds the activities that require it, whether it's small or medium enterprises, and/or infrastructure. And at the moment we, unfortunately, have a system that does neither.

We have a system that is very prone to crises and which, particularly now, does not fund the key activities. So there is, I think, a major challenge to transform it and to design the kind of regulation which will both limit systemic risk to make crises less likely, but also allow enough space for financial institutions to lend to the real economy and to provide for real growth.

Thank you very much.

MR. DERVIŞ: Thank you, Stephany.

I think I will come back in the panel part to the issue of, you know, who should be implementing the countercyclical regulation and how does it fit in with inflation targeting and central -- and, you know, the kind of objectives of the Central Banks. So this is something that is much debated, and I think in the discussion we might come to that because I think you put the objectives. But there is the question of who among the institutions would be trying to implement these instruments, which I would like to come back to.

MS. GRIFFITH-JONES: Sure.

MR. DERVIŞ: But now we'll turn to Gerry Caprio.

MR. CAPRIO: Thank you very much, Kemal. It's a pleasure to be here. I will take off on a couple of Stephany's comments, but, first, actually, I think I'd like to start by announcing some very good news, and that is that this crisis is actually just a collective bad dream. It could not have happened. It could not have happened because we had legislation in the U.S. that goes by the acronym of FDICIA, the Federal Deposit Insurance Corporation Improvement Act, that mandated that regulators were supposed to step in as banks' net capital position declined below 10 percent, and with each decline take more and more strict actions, ultimately closing banks down while their net worth was still positive. So we must have just imagined this crisis.

Now, the point of this introduction is not to let you think that there was something in my coffee this morning, but rather the fact that until we understand why FDICIA failed -- which is a question that people are not asking nearly enough -- the notion that we're going to reform financial regulation and be any more successful than we were in the past is just wishful thinking.

As Stephany mentioned, there was a good bit of regulatory arbitrage that went along, and whether regulators were sitting behind a Maginot Line named FDICIA in this country, or the Basel approach to bank regulation here and abroad, the arbitrage was pretty amazing. We saw a tremendous decline in the quality of information in the financial sector, and a marked change in incentives in the sector where people in the sector were making what used to be regarded as lifetime fortunes all within a year or two.

Various regulatory bodies should have known what was going on. In every crisis there are very visible signs before the crisis or even before individual bank failures. A favorite example is Bank Lyonnais. Before that failed, its advertising slogan was -- sorry, Credit Lyonnais. Credit Lyonnais, the power to say yes. They wanted you to know that your loan was going to be approved no matter what.

In the S&L crisis here in the States, we had one bank that had advertised that it was the first to apply for a license to do business on the moon. They were trying to stress pro-growth thinking. Well, in this crisis we saw leverage ratios explode in the financial sector. We saw household debt ratios going up. We saw advertisements wherever you cared to look that banks will actually give out loans getting no information about the borrowers at all. So, and we now know that the Fed, and I assume the OCC, were receiving FBI reports as early as 2004 documenting widespread fraud going on in housing finance. If they acted, we still don't know what actions were taken.

My conclusion is that -- and it goes back to actually an article that Joe Stiglitz wrote, oh, about 10 years ago when Ed Kane had also done work on this, that we have to take account of the regulatory dynamic; that any static set of rules is going to be arbitrage by the industry. And so we need a process to ensure that regulators are going to be looking to see what's going on in the industry and adapting their regulation supervision to those actions.

The notion that Congress or parliaments in any country around the world are going to reconsider financial regulation on a regular basis is probably -- well, maybe a pipe dream or a nightmare would be the terms that would come to mind. It's not going to happen. So we need to find a way to have the regulators adjust to what's going on in the sector. I don't know of magical solutions here.

Financial incentives are one thing that come to mind. Having deferred bonuses, incredibly generous pensions that could actually be taken away from regulators, the problem with that solution is it's going to be really hard to write that contract. But I know at least several people who would like to see the pensions of some former regulators sacrificed as a result of this crisis.

Another way that a colleague and I, Ross Levine, have discussed, is try to come up with a -- though I shudder at the thought -- of a new regulatory body, but a very tiny regulatory body whose sole task is to report on whether the systemic risks in the system, and what are the regulators doing about it.

Andrew Lo at MIT has a proposal that after every crisis there should be an investigation equivalent to what happens after an airplane crash. My view is that financial crises are too expensive and damaging to wait, so why not have a financial regulatory commission that issues an annual report on the state of systemic risk and, importantly, on what the regulators are doing about it? That might be a step in the right direction.

I would close with a quote from a different sphere, that is the defense theorist von Clausewitz, who said if you entrench yourself behind strong fortifications, you compel the enemy to seek a solution elsewhere. He didn't know it, but he was talking about financial regulation.

If we think that if we had just built the Maginot Line a mile longer that the French would have been safe, we're kidding ourselves. It's the wrong approach to defense, it's the wrong approach to regulation, and it's not being discussed in the legislation that's being considered in the U.S. today.

Thank you.

MR. DERVIŞ: Thank you very much, Gerry.

Very good. And I think you have very concrete proposal also, you know, that's there, and I must -- I hope we will discuss it directly because I do believe it has huge merit.

Now, turning to the International Monetary System, I think mostly -- or any other thing that José Antonio wants to address, but just as a starter, José Antonio, I'm, you know, looking forward to our course in the fall. I'm quite confused because this whole global imbalances thing. You know, on the one hand, Alan Greenspan in the Per Jacobsson lecture two years ago basically said with financial globalization it's very natural that people will allocate their savings according to highest return. Current accounts are just byproducts of capital allocation decisions in a global economy. They don't really carry much importance in themselves. And, you know, the vision that comes from that is a world where current account deficits and surpluses will grow reflecting, you know, reflecting a much more globalized economy.

And then there's the other kind of debate which sounds as if basically everybody had to have a current account more or less in balance, you know. I mean, current account imbalances are bad and so, you know, basically, that the smaller they are, the better. Anyway, that's just my kind of confusion in the beginning, and maybe you can address it a little bit.

MR. OCAMPO: Okay, thank you, Kemal. Let me start by thanking you, Brookings, for hosting this event. I think we have a really great book and this is a great opportunity to introduce the book to you. And thank you, of course, all of you, for attending today.

Let me start by answering your question saying that I think risk management is fundamentally wrong. I think what developing countries have learned through a series of crises is that relying on capital flows is bad for stability reasons and for growth reasons; from stability reasons because the reversal of capital flows has generated a significant number of crises, and those crises are harder to manage if there is an initial current account deficit. And I think the countries of Central and Eastern Europe have learned that again -- that lesson again, as Latin America learned in the past, as Asia learned in the past, as many developing countries learned in the past.

And for growth reasons because -- perhaps because capital is unstable and, therefore, you cannot have a stable financing of a current account deficit, developing countries have also learned that the, let's say, export-led growth is much better than, let's say, external savings as a source of annual growth.

And I think these two underlying resources why developing countries acted differently, particularly during the boom, but of the, let's say, 2003, 2007, you know, relative to all general orthodoxies, let's say, on this issue. So what countries did was actually not to control capital again. You know, this is an interesting point in one of the chapters that -- the one by Yilmaz Akyuz, which says, you know, perhaps the agents learned the wrong lesson from the crisis. They should have probably gone back to capital regulations, capital account regulations, and they did not.

But what most of the countries, particularly the Asians did, was accumulate massive amount of research, so this is -- and it's a prudential reserve accumulation of a massive scale we have not known before.

Now, from the perspective of the countries I think, this is something that is behind several chapters of the book that turned out to be good. I mean, the countries, actually developing countries except for, you know, the emerging economics in Central and Eastern Europe which were very badly hit, were much less bad hit by this crisis in financial terms. In trade terms, of course, many were. But in financial terms, you know, developing countries and emerging markets were relatively well-served this time thanks to that massive amount of reserve accumulation which allowed them the policy spread they had never enjoyed before.

Now, what is the problem that the book raises? Well, the problem is that that which is very logical from the point of view of individual and perhaps for the collective developing countries has one fundamental flaw, which is a collective one. It's a fallacy of composition. That developing countries as a group do this, there has to be other, you know, parts in the world, an industrial economy in this case, that has to be running deficits because otherwise the system doesn't matter.

And, of course, during the boom it worked very well because the U.S. was acting as a consumer of last resort, you know, running deficits and accumulating a huge external debt. But that was precisely, you know, the situation that, you know, could not work, you know, in a sustainable way. And, unfortunately, I think that if we go back to business as usual here, we're going in the wrong direction.

And this is why the -- you know, in the last two -- the last part of this book contains two chapters that present proposals of the reform of the global research system as a way out of this, you know, fallacy of composition. It has to be a system that, you know, in my version, in my chapter through the IMF and Joe Stiglitz and Greenwald's chapter, more to the creation of a new institution, the Global Reserve Bank. But in both cases, you know, the common issue is you have to essentially issue global money in amounts that are sufficient to absorb the increase in the amount for international research.

Now, and that will be useful to generate -- I mean, in a sense help to correct the incentive for global imbalances, but it will only work to the extent that the countries that receive that flow of money, let's say, a special (inaudible), are the countries that demand research, that is the developing countries. So you have to have a system in which the allocation of research -- excuse me, of this special (inaudible) or any global money has to go to the countries -- to developing the countries in a large proportion. So there has to be that development link.

There are many proposals for that and, you know, my own proposal is that it should be, aside from the IMF quota, there has to be a criteria of demand for research in the allocation of special (inaudible) in some way. We can go -- come back to this issue.

And, finally, you know, you can use the same global money issuance to finance IMF progress. So IMF progress, it would not depend on either quotas with countries' moneys, let's say, as they are now or on arrangements to borrow of any sort.

So in my proposal, for example, the idea is that the SDRs, or whatever, you know, will be considered, that are not used by countries for -- because of the deposits of countries in the IMF which would then be able to lend those deposits to countries in need. So that the, actually, the mechanism by which you create global money is also the mechanism by which the IMF lends, which is the way any Central Bank in the world does this, and there is no reason why the IMF could not do it, you know.

Thank you very much.

MR. DERVIŞ: Thank you very much, Professor.

So this is another key dimension of the debate, and, of course, we're going to have trouble time-wise covering all these dimensions.

But, Otaviano, you will help us by putting some structure into it, and giving your reactions.

MR. CANUTO: Maybe the one is the hardest sell here. Inevitably, I want make justice to the richness of the book, but let me tell you at the outset that as far as I'm concerned, this has been the best book that I have read so far about the financial crisis for several reasons. First of all because it's a collection. It's a Dream Team. It's really a group of writers very, not only competent, but also they can boast that they have been saying some of these things they're saying in the book for some time, and I'm a testimony to that.

But also because reading the book as a whole gives you -- doesn't give you a monolithic treatment of the crisis. The bright minds there allows us to have, in fact, an array of issues and treatments with several nuances that I will try to highlight some of them. It is not monolithic, but it's a powerful set of papers, particularly if I tell you the following. Putting together from the first chapter by Stiglitz setting out the macro foundations of the mess, one understands fully how we had a machine or maybe a bomb ready to be sparked.

And -- but in combination of the treatment -- in combination with the treatment given by Stiglitz in his first chapter, one goes to Gerry Caprio's chapter on the universal constants, and reading together with Kregel chapter, which is one that demonstrates or shows historically how, in fact, this third episode of major financial turmoil in the U.S. has a lot in common with the two previous ones -- one in the mid of 19th century, but also the one prior to the Great Depression -- and how, you know, the U.S. banking system has been -- well, the issue of the fight against trying to curb the banking activities vis-à-vis the capital markets is a pendulum. And in having, you know, the Stiglitz chapter shows how the U.S. financial system went to the apex, the limit of these -- of the generation of this proneness to a disaster because of the symmetries of information being maximized by existing configuration of the system.

But, also, one has to read it together with Gerry Caprio's and Kregel's to observe how, in fact, even in this historical specificity, we have durable dilemmas faced by regulators in the history of the banking systems in this country and elsewhere.

But also, again, the third complement to this three-pronged treatment to the crisis that in my view was contained in the book is the chapter by D'Arista and Stephany, one in which they make the point that we watched recently the last point, in fact, on a long capital flow cycle that has been on since the '80s and the '90s, and so it was in a crescendo to exploding.

So this combination of chapters give to my view the vast assessment so far that I have seen on the financial crisis.

Now let me make a couple of comments on the -- I will not praise the several other important aspects. I will leave it to you guys when you read. Let me just talk about some of the doubts, first on the reforming financial regulation and then I will center on Stephany's chapter.

I think on the two-pronged approach recognized by Stephany, the one about the need to be a countercyclical, it's a point that both she and José Antonio have been making for a long time. Well, the guys were right. Now, it's no longer controversial, but they were the ones in the end of the '90s and beginning of this millennium to highlight the procyclical features inherent to banking systems increasingly, but also to Basel I and even Basel II as it came out, they were the ones who highlighted it.

So I don't have much to add to that. Just the fact that we should remind ourselves that the boom-bust features probably they can be accelerated. They can be maximized by the financial system, but they go beyond the financial system. They come from behavioral traits of society and so any dream of eliminating boom-bust cycles has to -- being realistic, will never be able to -- we can't minimize the damage; we can avoid the multiplication of malign effects by having a good regulation, but not dreaming of eliminating them all.

As Gerry Caprio alludes to in his chapter, he gives an example of how effective were the occurrences of Barcelona in the 14th century. The guys managed to demonstrate how effective one can be in eliminating risks by decapitating, by beheading a banker. The flipside of this is that, you know, the banks moved to Netherlands and other places, and Spain faced several centuries of low growth. So let's be realistic, we will be able to mitigate, but never get rid completely of the boom-bust nature unless we intend to kill off innovation.

What leads me to the comprehensiveness, which is the second prong proposed by Stephany, and it's hard to disagree with her when -- particularly if one takes into account, historically, reading Gerry Caprio and Kregel, how the possibilities of regulatory arbitrage have been at the core of dismantling of whatever existed as regulations systems, there is a minimal level of comprehensiveness and so on.

But again, always the devil is in the details in the following sense. Going for comprehensiveness gives us inevitably the risk -- the same risk that one has when one takes antibiotics for combating an infection. The worse thing that may happen is to cut short the treatment of an infection because you may get the situation in which your body has acquired anticorps, and then you are worse even than without taking the antibiotics.

And the task of going very far in the comprehensiveness is the difficulty to make it concrete. I'm thinking now more as a practitioner. I'm thinking of difficulties in getting around with some minimum standards when it comes to regulating banks, the difficulties, the demands, the high requirement in terms of change of law, in terms of setting up institutions' adaptability to national context and so on.

So the dilemma, I would say this because I, myself, have my mind in doubt on whether the kind of minimalist approach, as proposed recently in the U.S. by the U.S. Government in terms of establishing, again, some kind of Chinese Wall between different functions -- not necessarily institutions, but type of intermediary functions -- may be a second best vis-à-vis being two ambitious in terms of comprehensiveness. But I must recognize that the case that Stephany makes towards having a minimal level of comprehensiveness is well done, and we cannot be contrary to the very comprehensive, we cannot be too minimalist.

Moving to the reform in the global monetary system, again, the points made in the chapters by Ocampo and all the others, you know, are points that they have been making for some time. I must confess that I understand why the book insists on characterizing the accumulation of reserves as a matter of self-insurance, because this is an important complement of the process of excessive reserve accumulation by developing countries. But it is not all. By a reasonable measure, the level of reserves accumulation by developing countries in the last few years have gone much beyond any self-insurance motivation. They probably have more to do with their specific way of managing their exchange rates and so on.

But having said that, I fully agree with the costly nature of self-insurance mechanisms, which might be avoided if one had in place a more reliable collective insurance scheme. And one notes a more critical tune with respect to self-insurance both in Ocampo's chapter, but also in Greenwald-Stiglitz, whereas I felt Akyuz more willing to accept the self-insurance mechanism as a permanent feature of the system, is inevitably at the core of any proposal. And one has to be very -- no, there is no other alternative, let's face it. Even moving toward some kind of multi-exchange, multi-currency system will not eliminate all of the problems associated with having a single currency. We might end up even having a more -- a less stable system. And so logic and history lessons lead us to work with the possibility of, you know, SDRs, following Keynes' intuition, and somehow some mechanism to share -- to be more fair in the burden-sharing with respect to the adjustment. Namely, one of the beauties of having SDRs is that if they ultimately will end up meaning using more of the money of the currency of the surplus countries, this is a way to share a bit the burden of adjustment as Keynes aptly argued some decades ago.

But the problem I see, José, is the political economy feasibility of working with SDRs, particularly in the politically-laden way you proposed because it's a budget-softening measure. We know how tough it was to obtain the SDRs in the last rounds, in this recent round. Politically, I would say that it's hard to imagine that it's going to be feasible to count on regular issues of SDR in the future. And we cannot become too dependent on

SDRs, in my view, in order to build this whole new system. It's beautiful on paper, but, you know -- and my fear is that as time passes by, the tempo, the enthusiasm for broad reforms will vanish, will fade out. And the more ambitious we are with our proposals, the less likely we are to get meaningful results in the very short term. So this is just a word of caution.

I'm running to the end. I must confess that I have strong reservations with Roberto Frenkel and Rapetti's chapter talking about some kind of collective management of real exchange rates. It's -- well, one doesn't know exactly even how to estimate real exchange rates, much less so define politically in a system in which there is a redundant real exchange rate, much less even how to target real exchange rates.

I know we have to recognize that some countries have been capable of doing that, but they are so peculiar in the sense that domestic income distribution was endogenous, you know, in a way so as to allow for the adjustment, domestic adjustment, to the target exchange rates, and the conditions for a successful real exchange rate targeting are so specific that I doubt that they can be used even at the national level, much less as an international system.

And, finally, my last point. I also think that in the case of Asia, Akyuz' chapter, and José Antonio referred to, in the case of Asia, it wasn't financial sector. The impact has been on the real sides, but not really finance, maybe exactly because they have been using other kinds of defense such as the ones highlighted by José Antonio, capital controls.

Finally, a word of caution on using things like Anglo-Saxon model. (inaudible) the Canadian banking system came reasonably well after the crisis, whereas the German universal banking system, also, on the other hand, also demonstrated how, you know, the propensity to undergo risks and so on is not a monopoly of one specific Anglo-Saxon or non-Anglo-Saxon model.

But overall, as I said, this is a fantastic book, the best book, my best reading, about financial crisis so far. And I would urge each one of you to also enjoy it as I did. Thank you very much.

MR. DERVIŞ: Thank you.

Well, Otaviano, that's a pretty strong endorsement, so it couldn't be better than that.

Well, you know, we want to have some audience discussion, so I'm not sure how much we should follow the script, but let me nonetheless ask one question. And maybe Stephany and others might also come in on this countercyclicality because I think it is critical. It has been something that José Antonio and Stephany emphasized for a long time, but maybe just not too long, but a few elaborations on how it should be implemented. I mean, is it just a narrow financial sector regulation-type countercyclicality? Or are you thinking, also, you know, of dealing with asset price bubble issues? How does it fit in with the inflation-targeting monetary policy framework?

I mean, you know, narrow inflation-targeting, picking, let's say, 2 percent inflation no matter what as monetary policy is not very countercyclical, okay? You know some people are proposing nominal GDP targeting, which would have, you know, some countercyclicalities over the real economy.

But you haven't discussed the macro side of it. But I think it's very hard to separate countercyclicality in the narrow financial sector regulation setting from a broader approach to countercyclicality as a key feature of macroeconomic policy. So maybe one or two words on that would be useful.

MS. GRIFFITH-JONES: Yeah, I'll answer briefly so -- of course, José Antonio can also do that because he's still writing about it. I mean, I think if we start from Joe Stiglitz's excellent book with Greenwald, when he says that actually in modern economies the credit variables may be more important than the monetary variable in terms of the impact on the real economy. And we think that we don't have now direct control of credit as we did in the past, but control of credit by the authorities mainly through regulation, we see that regulation is actually an important tool of macroeconomics policy.

And so I see it as combining with a sort of -- as the missing pillar of you have countercyclical monetary and fiscal policy, but you didn't have a similar tool to control credit creation, which is also has a major impact. Even macro models don't include the financial sector, and that's a major failing.

So I think that that -- so countercyclical policies, I think, on the regulatory side should be done by national Central Banks looking at their cycle, but also I think being aware -- and there's a nice paper by Bill White, formerly the chief economist of the BIS, looking at the externality. So it's different if one country has a boom than if all countries, for example, have a boom of property prices. The likelihood, I think, of a problem will be enhanced.

So I think countercyclical regulation of credit throughout the financial system could actually strengthen the hand of monetary and fiscal authorities. You have, I think, different objectives. As you said, you have the objective of inflation, you have the objective of growth, and, thirdly, you have the objective of controlling asset price. So if you have three objectives at least, then you need, I think, three policy tools. And so you have monetary and fiscal -- monetary policy for inflation, a fiscal policy for growth, then you need a third one to help you control asset bubbles made.

MR. DERVIŞ: Gerry, would you like to add anything on that point?

MR. CAPRIO: Well, the argument in favor of that certainly is that it is an illustration of a dynamic rule the type of which I was talking about.

My only quibble is actually whether the Spanish and Colombian experience is such a great testimony to it. If anything, it tells us something about the difficulty of implementing countercyclical provisioning because it was done in those countries in such a way in which the requirements were actually watered down. So if you look at the change in total provisioning in either country, it was actually fairly small.

MR. DERVIŞ: José Antonio?

MR. OCAMPO: Well, in the case of the Spanish system and the Colombian system, I think is not -- was not as well developed. It showed that it could build a crucial provision that could be used during the crisis to avoid as a bailout in the case of Spain. So it did not curb credit.

And let me say that, you know, since I have been writing about this since 1999, I have that merit of having been one of the first ones to ever write on this issue. I said that from the very beginning what was clear to me, something like what Stephany was pointing out, that the, in fact, monetary policy may be quite ineffective in open economies no matter what exchange rate regime you have. So at the end what you want to control is the cycle of credit. So what we have to think is how to manage the cycle of credit.

And thinking about this was, you know, in my way of thinking, was, well, we need new instructions. And it occurred to me that actually using a prudential regulation was much better to manage credit than monetary policy as such because you could see many, many, many cases in which monetary became very restrictive, but then the credit boom continued. So that was exactly the origin of the idea, so that you need additional policy instruments. And this idea of doing it through capital or provisions or (inaudible) requirement or all of them in some mix is, in my view, the way to do it.

But just another point. Since I have been writing of this, again, for many years, and actually a paper I wrote in 2002, I pointed out that you could use them also in a discretionary way to stop specific booms. And actually, that came from experience because that's what we did to stop (inaudible) to one particular sector back in the 1990s. And the chapter on India, by Reddy here, showed that actually the Indian authorities used during the boom a prudential regulation that is increasing, for example, capital requirements or increasing the risk weight of certain lending as a way to try to reduce lending to the specific sector that they thought as risky.

And actually -- so, in my view, it's not only the general rules, but also the capacity to use prudential regulations to curb a specific lending when you see that going on very fast to specific sectors, for instance, all the specific assets or specific regions or whatever you think of being something that is becoming extremely risky. That's the way I think the usefulness of this instrument is.

MR. CANUTO: Can I just -- definitely, I believe, the major implication of asset price monitoring -- I'm not talking about asset price targeting, which is more complicated -- is that we are moving towards a world in which discretion will play a bigger role.

We were previously on the move towards moving towards rules: fiscal rules, and they are there, monetary rules such as inflation targeting, and so on. But when it comes to dealing -- managing the asset price-making, inevitably there's going to be more discretion than otherwise. It's an uncharted territory.

MR. DERVIŞ: All right. We'll open the floor to discussion now.

Yes, first, and then Jeff.

MR. BLACKMAN: Good morning. My name is Courtney Blackman. I'm former governor of the Central Bank of Barbados, and (inaudible) these two people I know quite well.

MS. GRIFFITH-JONES: We know you quite well.

MR. BLACKMAN: But, actually, I'm prompted to respond because of to say something of what Dr. Ocampo said, yes/no about the question of monetary policy in open economies, especially small open economies. And that is exactly what we did in ’90, ’82, too, in Barbados, ’90, ’81, ’82. Maybe (inaudible) targeted credit rather than money. And from the very beginning of the Central Bank in the ’70s, we targeted money -- credit, sorry, not money.

And on the occasion when we are forced into the IMF standbys, we used discretionary measures and direct restrictions and all kinds of things to do it right. And if -- but if the theoretical foundation for that policy has to do with what I consider to be the most critical thing, what are the state of your markets? Because we never believed that all markets were efficient or anything like that. That, to my mind, is a kind of religious thing. It’s not really -- had nothing to do economics, if you believe that, believe (inaudible). Faith, not science.

And so that we -- so we, therefore, asked ourselves that. And we decided that if you have imperfect markets, you cannot behave as if you have perfect ones. And I think that this is a bit -- well, at bottom of a lot of failure after that.

MR. DERVIŞ: Thank you. Thank you.

Jed? I will take two or three, and people should identify themselves and -- yeah.

MR. SCHILLING: Thank you very much. I’m Jed Schilling. I spent a lot of time at the World Bank, including with some of the previous global financial crises that we’ve dealt with, and the one in the ’80s with syndicated loans was kind of a prototype for the mortgage-backed securities, just a different basis for it.

I have two points I want to make. One, I think this is all very good, but we need to bring out one of the basic factors in financeology, which is the difference between real goods and paper goods, or real assets and paper assets. Because in the old days when I learned economics, it was production of goods that cycled around and people consumed them.

And as we've mentioned, the financial sector, up to a point, facilitates that. But in their creation of these paper assets, derivatives, and things like that, they've created these things, so they draw lots of fees by shifting them back and forth. They spend a certain amount of that on real goods, so those goods are either produced by borrowing money from abroad for our current account deficit or keeping wages of the rest of the economy low, or something like that.

So I think that this needs to be taken into account going forward because the estimates of financial assets of $600 trillion is well above the real assets that we have that produce goods down the road. So they're just creating paper that when the crisis comes, the government has to reprint its own paper to deal with that.

And one way that I think that we ought to deal with this is, in addition to the regulations talked about, introduce something that I would call "the financial insurance." Right now the financial sector gets free insurance for these crises, and we've spent hundreds of billions of dollars of taxpayer money bailing out the financial sector for the excesses and -- in addition to the cost people pay by lower wages and lost jobs and things like that. So all financial institutions, not just formally called banks, ought to be required to pay an insurance fee in extension of the FDIC that's based primarily on the size of their total assets, their leverage ratio counting all of the assets on the leverage side so that that would produce higher fees which would crate incentives for them not to be quite so risky, and provide a fund to help bail them out when that comes so all the burden doesn't fall on the taxpayer while the rewards get picked up by the guys running the financial sector.

So that would be my suggestion on the regulations.

MR. DERVIŞ: Okay, I stick to this side first and then come to the other side. Antoine?

SPEAKER: First is that I worry that when we look at this crisis, we have the sense that the crisis is over. But really we have just planted the seeds for the next crisis in the sense that we really have a real problem, I think, now with moral hazard and financial undiscipline of a magnitude that we haven't seen in many, many years.

And second of all, I think the success of avoiding the crisis in many emerging markets, including China, I think will lead to a hubris that will be at the root of the next crisis, which will probably come from China. That's point No. 1.

Point No. 2 is when I hear the discussions -- I haven't read the whole book -- the sense I have is of a focus on VD regulation and, you know, the irresponsible behavior of banks. I completely agree that that's important. But I worry that it misses the point, the major point. My sense is that when you're looking at this crisis, which unlike the messing up of emerging markets in developing countries in the '80s and the '90s was a crisis that was created in the developed world, that there is a problem that we're not looking at, and that the real problem on the line is a massive shifting global competitiveness. A massive shift.

I mean, remember, we used to have all the wealth, all the capital, all the technology. And now who have not just the labor, but also the capital? It's on the other side. That's a massive shift in competitiveness. And it's caused, I believe, by underlying factors that weren't discussed at all, which is decades -- by the way, bipartisan if it comes to the U.S. -- underconsumption, under -- sorry, overconsumption here and undersaving, overleverage. These are the issues that need to be addressed and that, in fact, have been aggravated because we are now forced to spend a lot of money on the government side.

These are the issues, I believe, that should be addressed. And the priority should be focusing on these issues rather than just on the narrow issue of regulation. I would love to get the comments of the panel on that.

MR. DERVIŞ: All right. We'll go back to quick reactions and then we'll get to the second round. Or should we take one or two more?

MS. GRIFFITH-JONES: That's fine. I think that's fine.

MR. DERVIŞ: Okay, we'll take two more, then. The lady there, and then you.

MS. SEIGN: Hello. I'm Elizabeth Seign, just a layperson. In plain English, could you explain what caused the financial crisis and what ordinary people like me can do to prevent it?

MR. DERVIŞ: All right. We need another day's meeting for that, but anyway. Yes?

MS. BACAROVSKI: Yes, Sam Bacarovski. I haven't read the book. I'm certain that I'm going to find many things that I like, but I stopped at the title because I've been suffering from the much too visible hand of the credit rating agencies for 10 years now, the most visible hands ever short of to find time for them to -- for additional visible hands. I think that there's been too much there. But that was just a comment. I have a question.

In this countercyclical, I understand regulations that want to optimize boom and minimize the cost of crisis. Those are regulations that take the world forward. But regulations that just want to give us a stable curve means that we're going to have a stable curve and be in the graveyard too early. So how can we instill enough dynamism into this countercyclicality regulation to take us forward and not just to keep us where we are?

Thank you.

MR. DERVIŞ: Okay, I think we better turn back and what -- how shall we do it in terms of sequencing? Well, we'll take the sequence of the speakers. You don't have to answer to every -- you know, what you particularly want to focus on. Stephany?

MS. GRIFFITH-JONES: Yeah, thank you very much, Thanks for the interesting questions and comments.

(inaudible) I may briefly comment on what Otaviano said, which I thought was very thoughtful. And his first point related to the last question as well about if you're doing countercyclical regulation, you will not totally eliminate they cycle. And there is a tradeoff with growth of lending and growth of the economy.

But I think one of the other questions sort of answered because what happened particularly in this last crisis, but always happens, is that a lot of the growth in the financial sector goes to finance speculative activity, which does not actually fund the real economy. All these derivatives as were mentioned and so on do not have such an important net effect on the real economy. So that maybe one can think in terms of certain sectors should be discouraged or even banned perhaps very sophisticated instruments that nobody understands -- nobody understands the risks, it benefits of a very small group of traders -- could be banned so the system could be simplified. And the same for developing countries, they don't have to follow this rule going into this very powerful, very sophisticated system, and, therefore, things could be easier.

So I think it is true that at some point there's a tradeoff between regulating very tightly, you could have 100 percent capital requirements, as Mankiw was quoted yesterday in The New York Times, then you wouldn't have dynamic role of the banks. But I don't think that's what we want.

But I think that there is a sacrifice that we face in any policies, and I think in terms even of poor people and sustained growth in the macro sense, it may be worthwhile to err on the side of caution.

Also, as Otaviano says rightly, you know, can we regulate everything? It would be too bureaucratic. I mean, an alternative approach is to say what is being said a lot in the U.S. and to a certain extent in the U.K., we focus more on systemically important institutions, on the large ones, because those are the ones that have been the most expensive to bail out. But I have, again, the fear, although I think that's a nice approach, is how do you define it ex ante? Did we know ex ante that Burston and Lehman was so systemically important? Certainly, I think nobody in the States or the regulatory agents knew that Lehman was so systemically important because not -- they wouldn't have let it fail.

So I just want to say one more point about I agree with the points that both of you made, and also I think a very important point was made about the success that the hubris could happen both in China and Latin America, our banks, or in Asia. Our banks did so well, we had no problems, so we're doing great and now we can liberalize, we don't have to worry. And, of course, that would be a big mistake.

Time for a Visible Hand, we agree, actually, with you on rating agencies. We think that they actually should be regulated because they have been appalling in the Asian crisis and have been appalling in this. They're very much part of the procyclical problem rather than part of the solution. But what we're proposing is a visible hand that will make the market work better.

We're not against the market. I think that is something -- but we feel that markets to be efficient and for these economies to have a chance to compete with the Chinas and the Indias, they need an efficient financial system. And it can only be so if it is well regulated and if governments oversee it for the public good of long-term stability.

MR. DERVIŞ: Gerry?

MR. CAPRIO: Well, I guess just a couple of reactions to the questions, and it may serve to answer the global question on what caused the crisis. I certainly see it as -- and actually it was an article that Brookings published by Akerlof and Romer a long time ago about looting in the financial system, about how insiders can, in effect, steal money from the banks that they're working for by paying themselves out of current compensation and that current compensation being inflated relative to their real profits.

We saw a sea change in compensation in the financial sector around the world. It wasn't just in the United States that this happened, where -- I just came back from a semester in Ireland, and they had or are still having a horrific crisis. It wasn't just the bad securities that were originated in the U.S.

First of all, many of these securities were bought by foreign institutions. Why were they buying these securities? Well, one factor was that they were paying their fund managers on the basis of the return that they could earn relative to their competitors. So if they could buy triple-A-rated securities that were paying a little bit more than other triple-A-rated securities, they got huge bonuses.

And nobody was asking why were these triple-A-rated securities paying a little bit more? And it turned out that there was something about their riskiness that really should have been focused on. I think Antoine is exactly right that there are certainly underlying macro forces, countries trying to maintain consumption patterns after they've lost competitiveness.

But even that said, you want to look at the differences in regulation in terms of how the crisis played out in different countries that were suffering from that common shock. And that's why I do think regulation has some role to play. It's not the only answer to this question, but it's been said before, to a man with a hammer every problem is a nail. My hammer's regulation, others have their own hammers.

MR. DERVIŞ: José Antonio?

MR. OCAMPO: Let me just say -- I mean, reinforce two points, reinforce this issue of that the countercyclicality's not to eliminate the business cycle. I think that's impossible, actually because each business cyclically different from the previous one. So it's -- and each crisis is different from the previous one, so. And that's why, you know, no fixed rules for anything will work without the accompanied good use of discretion of economic authorities.

But the second point is regarding this financial insurance question, which I would say that, first of all, my -- you know, the idea of the provisioning system is, in a sense, exactly that. Because the ex ante provision, not the, you know, the Spanish system of ex ante provisioning, because the -- I, you know, the way I express it is that the banking industry has to go to the accounting rules in a sense of the financing -- of the insurance industry. And the insurance has clearly recognized that the risk is incurred when you issue a policy and then you have to do the provisions immediately.

In the banking industry, for some crazy historical reason, that's not so. The provisions are made only when losses are made or where losses are expected to made very soon. That is exactly wrong. So you have to go to the principle in which the provisions have to be made when a policy -- when a loan is disbursed. That's the time in which the bank is incurring the risk. And exactly that is the system, the change in mind, that has to be made in the provision system. Provisions have to be made exactly at that point. And that is exactly what the insurance component is.

So you have to -- I mean, in the real idea which actually the Spanish were forced to change because of the, you know, accounting rules, international accounting rules, which on this point are exactly wrong. So they were forced to change the original system. But the original system they had is they had to make provisions which tried to capture the obvious laws of a group of laws. So that's exactly an insurance mechanism.

SPEAKER: May I say just something on the point, and I fully agree with you that, in fact, we are watching tectonic shifts in the global economy. That's just, I think, on some figures we have roughly one-third of the world population that has been incorporated into the market economy in the last two decades. And in an environment that has learned a lot about how to do things in terms of development, the latecomer advantages for those countries that come afterwards and who can enjoy the technology from the frontier, they have been less enjoyed by other countries in the past because of a lot of bad policy that were impermanent in the past, and some of these countries have learned.

Look at the fiscal landscape in Muslim -- the guys -- one has learned. So you -- one puts together latecomer advantages, better behavior in terms of economic policies, and the shift of population, the world is still coping. But this does not eliminate the relevance of cutting the financial crisis as such in the sense that the determinants of the financial crisis, I don't believe, can be traced back to this tectonic transformation.

Otherwise, we come to start talking about saving glitches and putting the fault of the crisis on elsewhere. I think the brunt of the crisis has to do with, at least on the financial side, with it here. So shouldn't there be a

-- and it's impossible to resume in plain English in a phrase this crisis, but just one thing: There was a major -- one of the major economists of our century, Joseph Schumpeter, who thought that by developing good analytical models the economist might be able, ultimately, to get rid of ideology where at least it would confine ideology to a very, very square domain.

We watched something in the last few years just reverse. We developed an ideology on the models. Economists start believing too much their own models and models of efficiency, and in some kind of ideological faith took, seized control. And while there were signals of that a disaster was coming, collectively we're not able to grasp and face it in reality. So we're having the -- we're undergoing the hangover of a period of relative blindness of the profession and the interested people in the process as well.

MR. DERVIŞ: Yakot?

SPEAKER: So far the discussion has focused on how to prevent the next crisis, the role of regulation. I'd like to ask the panel about how you deal with a crisis when you're in the middle of one. And the challenge that they faced last year was it became apparent that they needed to provide capital into the banking system, so we needed a sort of capital provider of last resort. And the problem in the middle of the crisis was that they wanted to provide capital on relatively lenient terms because that seemed to make sense when we were in the middle of the panic.

Ex post now there's this incredible political reaction against what they did, particularly in this country, and it was viewed as essentially a giveaway to the banks. How does one deal with that issue of providing capital, capital in the crisis, and providing it on terms that make it appealing to banks in the middle of the crisis without it being a giveaway?

MR. DERVIŞ: Yes?

MR. KEIDEL: Thank you. I'm Albert Keidel with the Atlantic Council of the United States and Georgetown University, and I formerly managed the Office of East Asian Nations at the U.S. Treasury Department. I just have a quick comment on how to target the regulatory agencies rather than naming institutions and defining them, but to name activities and define the activities wherever they are, whoever is doing them.

My question is about the book, which I look forward to reading. To what degree does it point to ways that the financial sector needs help from outside the financial sector in order to be effective? And I'm thinking in particular of two things: One is the role of lobbyists and internal politics, really the nature and quality of democracy as it influences the regulatory bodies, which would point to -- I mean coordination, internationally, is sort of a weak-sounding term, but some way that keeps Wall Street from competing with the City of London by lobbying its government to help keep it competitive.

And the second has to do with really the making the financial sector effective in the real sector, which is the fiscal side; that how do financial systems need help from the fiscal side in accomplishing their countercyclical goal and targets? And this then I think extends to the growth of liquidity globally, which I wonder what you would say to not centering liquidity expansion in the IMF, but really in those bodies that have a fiscal role around the world, the development banks led by the World Bank, but also in Asia, Africa, and otherwise; that when unique countercyclical effect, you really need to know where to put the money so it creates the jobs. And the financial system, it seems to me, to have proven itself to be rather ineffective when you push on the string, the old phrase.

MR. DERVIŞ: All right. We're running -- oh, yes, I saw you. I forgot you, sorry.

MS. ALEXANDER: Yes, I'm Nancy Alexander from the Heinrich Boell Foundation, and I wondered if I could hear from some of you about your view of the WTO Financial Services Agreement as well as the great swath of bilateral and regional agreements, all of which in some cases make it difficult to regulate the financial sector.

And my other question is just, you know, regardless of what your views are on Question 1, why isn't the whole matter of trade and investment agreements more of an integral part of discussions such as we're having this morning?

MR. DERVIŞ: All right. We're tight on time, so maybe very, very quickly a last quick round, and maybe I'll start with Otaviano and go the other way around.

MR. CANUTO: Okay.

MR. DERVIŞ: Very quick, though.

MR. CANUTO: All right, yes. On the -- on your point on the trade investments, there are several configurations that will have to be taken into account, not necessarily WTO was the best chamber for that.

One word of caution, which also reinforced the point that I made about the risk of trying to be too comprehensive. The world is so complex and we have such a differentiated landscape that sometimes things done with the best of intentions may break (inaudible). Let me give an example.

The OECD grade list, they are building a great list of countries of financial jurisdiction that are not compliant with very stiff requirements. And then when push comes to shove, we have several small states that simply cannot comply with those requirements because they are so demanding in terms of personnel, in terms of requirements, and they are running the risk now of being the victims of a process that is targeted at big things, at big.

Just to give enough flavor of how complex is the process of a trying to -- I still believe that the financial, properly financial regulatory chambers are the most apt to provide guidance when it comes to the financial sector. It is not a trade issue as such.

MR. DERVIŞ: José Antonio?

MR. OCAMPO: Yes. Let me just as -- well, first of all, this shows how to manage a crisis. I mean during -- actually in the seminar, members in the old -- that was in mid --

MS. GRIFFITH-JONES: November.

MR. OCAMPO: No, no. In mid-2008, when we had the first seminar I gave birth to this book, which had others later on. There was a lot of discussion exactly on this issue. And I recall in those discussions the famous phrase that the World Bank and the IMF were diffusing the (inaudible) our own developing country crisis, which was save the banks, not the bankers. But they're totally entitled. I mean the G-20 had never done anything. I am really, I find, for that reason, very fortunate that some staff members of the IMF started to write again about this issue. Because I think, you know, some of the prudential regulations that have to be adopted, particularly in developing countries, have to do with cross-border capital flows.

Thank you.

MR. DERVIŞ: Maybe I'll take the privilege of the chair just on Yakot's point for a minute. I was also in the same position, as was Antonio, you know, to having to take over banks. And the basic principle was the same, that if there was a complete kind of bailout situation, then shareholders would lose everything and basically the bank would be nationalized and then reprivatized.

Having said that, however, it was -- we didn't do it in 100 percent way that way, and it's hard to do it 100 percent, I think. The rule, for example, we used in Turkey was that if capital adequacy had fallen below 4 percent, there was nationalization. If it was between 4 -- above 4 and, you know, 8, then some advantageous loans, long-term loans, were provided. So in that sense the shareholders were helped, okay?

And the reason was that the capacity of the state machinery to manage the whole financial sector, basically, which would have been the case if we didn't put the 4 percent rule, was limited. So I fundamentally agree with José Antonio's basic approach, but I do believe that in practice, when it becomes very systemic, and I think in the U.S. it would have been very systemic -- you know, the capacity that the governments have to actually manage, you know, is a factor that one has to somehow keep in mind that it may lead to some dilution of the fundamental principle that if you're being helped -- you know, if the bank is being helped, the banker, the shareholder is not being helped.

But that -- sorry for intervening, but I thought that --

Gerry?

MR. CAPRIO: Well, I guess I would just add so what was dismaying about this crisis was not only how little the U.S. learned from other crises, but how little we've learned from our own. So if you go back to the 1930s on this issue of injecting capital, the Reconstruction Finance Corporation, at least under FDR, was making capital injections, but it was going it with a number of conditions that were very distasteful to the banks.

They had to be much more transparent about their activities. There was limits on what they could do. There were limits on their compensation and the government had to get paid back first. And that was a time of a systemic crisis. Yet, on average, the government got its money back within about five years.

The trick was that for banks that were horrendously insolvent, they didn't get RFC funding. And the government used the ability of banks to get some matching private funds as a way to identify which were the banks that they could try to salvage and which ones they had to just let fail.

MR. DERVIŞ: Stephany?

MS. GRIFFITH-JONES: Yeah, I mean, again, on this issue, I mean because up in the U.K. the government has been much more proactive than in the U.S. And yet you have the Royal Bank of Scotland with 82 percent of taxpayer money and government money, and then they give massive bonuses and the Treasury begs them not to give the bonuses, but, you know, they're 82 percent of the Board, so I don't understand why they just don't (inaudible).

They don't lend to the private sector. They don't lend to (inaudible). And again, the government is begging them don't do it. I mean, that's no comfort. So I don't understand, you know, why people kind of -- governments now tiptoe around running the (inaudible).

And I think it has to do with somehow the power of the financial sector, which even though -- and this is your question -- which is even though when it's bankrupt it seems to be tolerated, which is something kind of quite concerning. And I -- you know, my obsession with regulation would say the ideal would have been at that point -- I know it's difficult to figure out the process of inflation -- at the point when you give the bailout you say, as Gerry just said, you put conditions at least on things like bond (inaudible), but also perhaps on some kind of regulation, all of the things that caused the crisis. You know, you kind of -- because now when you talk to people in the financial sector and you talk to the journalists that cover it, they say it's back to business as usual.

So there is the sense that you've rescued the system, but it continues with the same way of operating which led to the problem. So I think that what you can do now, for example, (inaudible) all discussions about taxing the banking sector and involving the international groups so that you get small currency from (inaudible), much smaller than (inaudible). Even that meets a lot of opposition, but, again, that may be one way of controlling.

And I think the question that was asked about Wall Street and the power of the city and what it does to destroy -- to weaken democracy is something really very profound. And at the heart of all this discussion it is whether, you know, whether we can get a system of regulation and of running the financial sector in a way that is effective for the future, and that is crucial for the future of this country, for example, depends a lot on that.

And I chaired a meeting with Randall Dodd once in Brazil, and I (inaudible) why in regulative bodies don't you have some representation for the real economy from the borrowers, from the pension funds, even from the unions who suffer from all this as one way of counterbalancing of the influence of the (inaudible) to defend always the predator. I've been told that in the European parliament, for example, the -- that in the European parliament when legislation is being discussed on hedge funds, the people from the hedge fund industry is sitting behind certain (inaudible) passing them little pieces of paper, telling them what they have to say. And I don't think that's particularly valuable for democracy.

José Antonio didn't answer your question, although he's a great expert on this on development banks. And I think you're right that when we think about countercyclicality, we need to think of liquidity provision as the IMF has begun to do much more effectively in this crisis.

But also we need to have a very important response from the World Bank and the regional development banks because if not, big investment projects get paralyzed in crises, which we know only too well in developing countries and which may be a problem, and is particularly, I think, a problem now with investment related to climate change, which is so urgent and which is at risk of being not done enough because both private and public sectors are so severely constrained.

MR. DERVIŞ: All right. I think this was a great discussion. We could go on, of course, much more, but José Antonio has one last point he wants to make.

MR. OCAMPO: No, I --

MR. DERVIŞ: Or just a thanks.

MR. OCAMPO: No, I want to just say thanks to Brookings, to you, Kemal, but also to the two other institutions that supported this whole project, which are the Ford Foundation and the Brooks Poverty Center and the University of Manchester. That was the place where we held the regional meeting on this topic.

MS. GRIFFITH-JONES: And the German Corporation.

MR. OCAMPO: Okay. All right.

MR. DERVIŞ: All right. Well, thanks to you all, the panelists, and thanks to all the guests. And enjoy these next few days outside.

* * * * *

CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III

Notary Public in and for the Commonwealth of Virginia

Commission No. 351998

Expires: November 30, 2012