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ASSESSING THE EURO SUMMIT

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## P R O C E E D I N G S

MR. ELLIOTT: (in progress) -- for you, as I'm merely the moderator. So I won't actually be talking that much.

So, first of all, welcome to Brookings. I'm Doug Elliott from The Brookings Institution. Thank you all for coming. We have four distinguished panelists who are going present their assessments of the most recent Euro Summit.

First, and I'll go in order here, Antonio de Lecea is the economic minister at the European Union's delegation here in the U.S., and he's the principle advisor to the EU's ambassador. Prior to coming here, he had a distinguished career in Brussels, including as the economic advisor in the personal office of Commission President Prodi. And then he was director for international affairs in the European Commission's Directorate General for Economic and Financial Affairs.

To his right, Desmond Lachman is a senior fellow at the American Enterprise Institute. His background includes prominent roles in both the private and the public sectors. This includes 12 years at the IMF -- if I counted correctly -- and 7 years as the chief emerging market economic strategist at Salomon Smith Barney.

To his right we have Carlo Bastasin, who is a nonresident senior fellow here at Brookings as well as a highly respected columnist who focuses principally on the intersection of economics and politics in Europe. His columns currently appear in *Il Sole 24 Ora* as well as other publications. He is currently completing a book on the financial and sovereign debt crisis in Europe.

And our final panelist is Domenico Lombardi, also a senior fellow here at Brookings. Domenico is a former member of the executive boards of both the IMF and of the World Bank. He is president of the Oxford Institute for Economic Policy, he is the editor of *World Economy*, and he also somehow finds time to work in more different

forums on global economic issues than I actually have time to list right now. But I'm sure if you look at his website -- or our website for him -- you'll see a very long list there.

So, after our panelists each speak, I will ask them a few questions and then turn it over to you in the audience for a question-and-answer period. So I will begin with Antonio, then we'll follow in order with Desmond, Carlo, and then Domenico.

And if you'll excuse me one minute, I'm going to close the doors so you can hear a little better without -- oh, thank you, sir. Antonio?

MR. DE LECEA: Thank you, Doug, and thank you for the introduction and thank you for the opportunity to share with you some of our thoughts that are close to our heart and for being with such a distinguished panel. We have -- and we know that we don't agree on many things, but I'm sure that it will be an interesting and lively debate for yourself.

Coming back to the main title and the main issue of this evening, assessing the Euro Summit, and I would like to start by saying that the assessment is implicitly or explicitly made against the benchmark, or against the expectations, so setting the right expectations is crucial. And I will tell what our expectations were. Our expectations were to achieve one short-term objective, which was to take immediate action on a comprehensive response to the current crisis so as to restore confidence, the confidence that we know that has been shaken and that we know that it will take long to recover.

The second is a longer term objective, which is to make clear -- even clearer -- the firm commitment to the euro and to the irreversibility of our currency, which, as you all know -- I mean, we tend to read the press -- was very much in doubt in the days prior to the summit. So let me underline again that these two objectives, and like what is sometimes hinted to, cannot be taken separately. Why? Because the solutions

to the immediate crisis involve instruments that will either be permanent or will have longer term implications and risks.

And another point that I would like to underline is that these instruments can only be built on mutual confidence and that some of the measures that have been agreed and some of the measures that have not been able to be agreed can be traced to the issue of the time that it takes to build confidence.

So we agreed that these objectives had to be reached through a comprehensive strategy. A comprehensive strategy that involves at least four issues. One was more discipline or clearer discipline, and the signal of more discipline.

The second is that the fiscal is not enough and that the structural reforms for growth and more investment are as crucial as fiscal discipline.

Thirdly, as we have seen, much of the problems have come from the divergence amongst countries. So more convergence is also part of the solution.

And finally, we can have discipline, we can have structural reforms, we can have convergence, but some countries will still be in a dire situation and we also need solidarity, and the union also means solidarity. And, again, we believe that all those elements belong together.

So the other point that I would like to underline is that the summit builds on a number of measures that have been taken over the past 18 months. And I will not mention them, but they have all gone in the line of more discipline and more measures towards growth, both at the EU and, more importantly, at the national level, especially in the countries that have been subject to more pressure.

But we agreed and we understood that all of these measures that have been bravely at risk during the last 18 months were not enough. So this European Council had to show the joint determination to tackle persisting market tensions by

consolidating these achievements and reinforcing them even further.

So what is the outcome then against these expectations or this assessment? We think that as regards the substance we have gone a long way. We have achieved the agreement to create a genuine fiscal compact which will make a substantial stride towards a fiscal stability union to complement the monetary union that we have. So, on substance, we believe that this agreement has been ambitious and, more importantly, on substance again, it has been unanimous. And I will come back to this.

Unfortunately, our leaders were not unanimous on the form with one member state unable to join. But let me come back to the substance. On the substance, important conclusions were reached. One, coming back to the short term, there was agreement in increasing the firewall. There was agreement in providing 200 billion more euros to the firewall. How? Through the multilateral approach, through the IMF.

It was the agreement also to revamp and to improve our existing firewall mechanisms by putting forward the entry to force of the permanent firewall, the European stability mechanism, to make some of the amendments to the initial draft treaty so as to make it more flexible in times of emergency, and also to increase, if the need be, the size, and there will be. There is the rendezvous clause that in March leaders will look again at the size and see whether it is appropriate or needs to be reviewed.

And we also agreed to go forward in the leveraging of the current temporary or transitional mechanism, the European financial stability facility.

So, as I said, they agreed to complement the proper EU mechanisms with the multilateral approach by providing 200 billion more euros to the IMF in the coming days. And they also realized that one of the items that was agreed in May and July regarding the involvement of private investment was not right. So they decided to

change the policy and to make clear that in the future the treatment that has been given to Greece investors will not happen -- I mean, will not -- it was a one-off and that for the future the involvement of the private sector will follow the same principles as the IMF has been applying.

So it was decided to align our practice with the standard IMF principles so as to provide more assurance or to remove, let's say, uncertainty and anxiety on the part of the private sector investors, and does contribute to -- I mean, provide more funding for the countries and the financial sectors for which the international markets have been seized in the recent past. So that was on the short term.

On the medium term, as you probably know, there was the agreement on a fiscal compact, the fiscal compact which enshrines the commitment to ensure that as a general rule national budgets shall at least be balanced again, I mean across the cycle so that its structural balances will be balanced. To see to this determination they agreed that this should be enshrined in the primary legislation, showing the constitutions or the highest level of legislation in each country so as to complement the EU checks and balances with the national checks and balances and make this discipline really fully enforceable and fully enforced.

It was also a signal of the commitment to sustainable fiscal policies as a strong signal to markets that Europeans have learned from the past and are serious about this new stability culture. It was also a signal within the union that more integration is not a blank check for unsound policies. This is over. And it's a signal that we believe and we found that it was necessary for those member states that have run prudent fiscal policies to agree to go farther in integrating.

Now, again, coming back to the assessment, is this enough? And is this the fiscal union that we have in mind? Is this the broader economic union that we have in

mind? And one question that is in the air, can the ECB do more?

Well, the answer to that, and I will here introduce some of my own views on the subject, many of us believe that while the agreement in substance at this summit is quite impressive, we must go farther. We must go farther because we go farther in fiscal integration.

And in March, the European institutions intend to put forward again some of the elements that were already in the report that the president of the European Council and the president of the Commission tabled for the last European Council. In particular, the issue of European stability for stability bonds that has -- or euro bonds, as they are called. This indeed will prove to be very controversial for some governments, but we still believe the stability bonds can give an important contribution to this fiscal union that we conceive of.

And we believe that we need to go farther on another aspect, which is that fiscal is fine, but it's only part of the -- by addressing fiscal issues only, we will not solve the problem.

And some response was already in the conclusions of the European Council on the second day, not the Euro Group, but on the second day there were a number of decisions to further the agenda on growth and investment, but maybe something is needed also in this respect. And also, to go a little farther on the Europe of solidarity, so that as, again, for those countries that show commitment to fiscal discipline, for those countries that make a big effort in enhancing growth, there may still be cases where we need some proof of solidarity from the others.

So, as regards the last question, whether the ECB could have done more, well, the answer could not be found in the European Council, in the summit of last week. The ECB -- the European Central Bank -- as you know, is independent. Indeed,

it's the most independent central bank that I know of, so, therefore, it was not up to the European leaders to tell the ECB what it had to do or what it didn't have to do. And we will see.

The president of the ECB was very much involved in the discussion and intervened very actively. So it's up to the ECB to decide what to do, but we expect that having provided assurances that the governments have done their job, this opens up the possibility for the ECB also to stretch its powers, within, of course, the limit of the treaty, but to go as far as they can. So, as I said, on the substance there was quite a consensus.

On the form, as you know very well, there wasn't consensus and we could go quite far on 26, but one member state diverged. And since the original intention of the European institutions and of many governments was to amend the treaties, but amending the treaties required the unanimous approval of all governments, and one government was not ready, then that road was not possible.

So, once again, the European Council showed that it had the capacity to deliver even in very difficult circumstances. When this stumbling block arose, they found a way to circumvent or to solve the problem with the second best solution, that's clear. But a solution, nevertheless, which was an intergovernmental agreement that would go along the EU treaties and that would enshrine these new accomplishments, these new agreements that were reached last week.

So, to sum up, last week most heads of state of the governments of the member states showed their readiness to move ahead with European integration towards a more fiscal stable union. They show that they want more Europe, not less. They showed that they were ready to agree on an important issue, which was the fiscal compact. But many of us believe that more can be done, that the problems in the EU

area are not only fiscal, but also financial and primarily growth. We know that commitment to fiscal discipline is indispensable and that it has been necessary for any other measures to be taken, so they are taken now. And it maybe opens up the possibility for further measures.

So, I think I will stop there. This was the main message. So the assessment, we believe it's good. We believe our leaders did what was necessary to further integrate, what was necessary to address the crisis because the crisis needed long-term commitments and long-term commitments can only be based on mutual trust and mutual trust can only be based on discipline and long-term agreements. So this was achieved.

What was not achieved was to go the way we meant to do it. It will now be more complicated with the treaty and these parallels, but we believe a convergent new treaty. But we believe that we have gone a long way and we hope that the rest can be obtained in the very recent future. Thank you very much.

MR. ELLIOTT: Thank you, Antonio. We'll turn to Desmond Lachman now for what I'm confident is a rather different view.

MR. LACHMAN: Yeah, I'm not going to disappoint you. I can understand Antonio's position. If I was in his position I'd try to make the best of it as well. But before I give my assessment, I might just mention that the market's assessment is a little bit different. On something like Wednesday or Thursday of last week, Italy was raising money at 5.8 percent. Today it has to pay 6-3/4 percent.

Just to put that into perspective, Germany placed a bond today and was paying .2 percent. So far from assuring the markets that Europe is on the right track, markets didn't seem to buy this. The euro dropped below 1.30. I don't think that the markets are always right, but I think that in this particular instance they seem to have

read it correctly.

What I want to do is just take a different line. I just want to remind you why one needed the summit. That we had a summit around about July the 21st that was supposed to solve all of the problems. And then what we saw between July 21st and October 26th was massive intensification of the crisis. We saw Greece, for instance, its economy in freefall, its government failing, deposits leaving the system, only a question of time before it has a coercive default, you know, that might involve a write-down of its debt 70 to 75 cents.

We then saw the crisis move on to Italy, Spain. We saw it hit France as well. So this was really getting serious, that these countries were too big to fail, but, as they say on Wall Street, too big to bail.

We then saw that France and Germany, all of the short-term indicators of France and Germany are telling you that those countries are going into recession, and to make matters even worse that we've now got the banks are short of capital and the banks are at the start of a vicious credit crunch where people on the street are making estimates that you could be seeing a reduction in credit by the European banks of anywhere between 2- and \$3 trillion over the next 18 months. So this wasn't exactly a great backdrop, so that's where I'd like to start.

The second point I'd like to make is, what is the diagnosis of the problem? Why are we in this position? And here I totally disagree with what they've done at the summit, where they think fiscal austerity is the solution. Basically, what you've got is you've had countries within a currency union that for 10 years didn't play by the rules. And what they did was they ran up huge public finance problems in the form of budget deficits, 10, 12, 15 percent of GDP. Debt levels, instead of being at 60 percent, go well in excess of 100 percent. So they developed a public finance problem where the

debt dynamics are totally out of control.

The second thing that they did is they lost huge amounts of competitiveness, to the tune of something like 20 percent, opening up big current account deficits. The problem is if you're stuck in a fixed exchange rate system, normally the way in which you'd address this problem is you'd have a very large devaluation that would spur exports that would then allow you to engage in fiscal contraction without totally tanking the economy. This they're not doing. They're not riding down the debt.

So what they're doing is the IMF, together with the EU, shows up in whether it's Greece, whether it's Portugal, whether it's Ireland -- soon to be Spain and Italy -- just saying, you know, tighten the fiscal belt. Well, we've seen the results in Greece. Greece's economy the last 18 months has contracted by 12 percent. The budget far from narrowing to the levels still remains at 10 percent. Their debt, which was supposed to come down to 130 percent -- was supposed to peak at 130 percent of GDP, IMF is saying it's going to peak at 190 percent of GDP. And I don't see why we're going to get a different result when we try the same kind of recipe in Portugal, Ireland, Spain, and Italy.

So I think that the diagnosis is wrong. What you've got is you've got a solvency problem in many of these countries. You need a debt ride down and probably you need some of these countries to exit the euro.

I've mentioned that what we've had is a huge credit crunch in the sense that the banks are short of capital. The IMF estimates -- and this was according to markings when the bond spreads weren't quite so wide -- they estimate that the hole in the bank's capital is around about 200 billion euros. It's far likely to be more than 300 billion. That is a problem that's got to be addressed. The Europeans made a huge mistake way back in August, giving the banks until June 2012 to get to a 9 percent ratio

on the capital. So what the banks are doing is they're engaging in deleveraging and tightening credit.

So, if I were looking at the summit, what the summit should have been trying to do is they should have, firstly, tried to build a firewall around Italy and Spain. You know, perhaps say that Greece is an exception, have a real firewall. And what you're talking about, if you just look at the debt numbers on firewall, 200 billion euros is trivial. You know, what you need is something like 2 trillion euros in order to prevent this crisis impacting Italy and Spain.

What should have been addressed as well is they should have done something about the credit crunch, to prevent the credit crunch from occurring. They should have been dealing with Greece and they should have had policies that promote economic growth. Instead of which, the way I read it is, they certainly didn't produce a bazooka. Two hundred billion euros is not going to be nearly enough.

They didn't get a treaty that would have given the ECB cover to go in and buy the bonds in size. Instead of which, what they did is -- in my view -- they engaged in a policy of economic lunacy in that when you've got countries that are moving into recession, the last thing you want to do is have coordinated fiscal tightening of 2, 3, 4 percent of GDP -- not for 1 year, but for 2 or 3 years -- and at the same time have a credit crunch. I don't think one's got to be a rocket scientist to predict that Europe now goes into deep recession. They don't meet the fiscal targets. They get a political backlash against this and I'm not sure what rabbit they're going to pull out of their hat.

So, in short, if I haven't been clear, I'm not overly optimistic about the prospects for Europe and I'm very worried about the impact that it might have on the United States, but that is a topic for another occasion.

MR. BASTASIN: Thank you, Doug. The first lesson that you learn when

you publish your opinions is that you need to be counterintuitive. You need to provide a different visual angle or to draw conclusions that are non-obvious. I always sensed that there is a limit beyond which being counterintuitive means being pro-stupid, so I'll try not to -- I'll try to defend my counterintuitive optimism in the euro area within those limits.

My main argument is that the political will behind the euro area in all the national member states is currently stronger than it has ever been before. Last November, we have seen in the euro area three changes of government in Italy, Greece, and Spain -- and Portugal and Finland and Ireland, sorry -- and all the governments of the five more visibly ailing countries have changed under the pressure of the crisis. But all of the new governments, elected or non-elected, right wing or left wing, have one common feature: for all the strain and pain that they had to go through, they have adopted a stronger, not a weaker, pro-European commitment.

With this latest fiscal package, for instance, the Italian prime minister, Mario Monti, is likely to take the tax-to-available-income ratio at the highest level in the euro area. But nevertheless, 60 percent of Italians are supporting the current government against the 24 percent behind Berlusconi; in Greece, Lucas Papademos, first with an identical advantage in popular support if compared with his predecessor. I may be going out on a limb, but I sense that the same happens in the rest of the euro area. Take Germany, for instance, where the most pro-European parties, the SPD and the Grünen, are up and coming. And for all the reservations of the German public, Chancellor Merkel is supported by stronger electoral polls whenever she takes decisions that go along the line of more integration while the liberal and the more radical parties staunchly opposing the European integration are in shambles.

The main reason why people crave a solution for the euro area is that basically there is no financial or political alternative. The costs of disorderly defaults or of

a breakup will be immense. The estimates of losses ranging around one-quarter of German GDP or one-half of the Italian GDP are surreal in the proper sense of the word.

Beyond the technical and legal complexities caused an end of the euro, the political consequences would be incalculable and Europeans seem to understand it. National interests are still alive, but the interest in the national is dead.

Why am I referring so extensively to the political landscape in assessing the outcome of the last euro summits were basically because politics was a crucial part of the design of the crisis solution, which required three different steps of a political nature. The first was restoring credibility in the countries under attack as required after the former EU Summit in late October, where the lack of compliance with the EU commitments undertaken by the past Italian government in the summer showed that it was indispensable, that those countries, and Italy in particular, were convinced to adopt important measures to mend their fiscal position and to enhance growth.

Second step was that also the causes of the crisis are not fiscal. Any form of support to exit from the crisis has a fiscal nature. Hence the European Council was called to contain in a credible and permanent way the problem of moral hazards, reinforcing significantly the surveillance of national political economies, and getting all countries to adopt constitutional constraints that would force them to keep their budgets balanced permanently.

And finally, the euro area countries are to create a convincing and permanent system of aid that would lead the euro area to embrace a system of fiscal union and reach the threshold of real political integration. Once this design is completed, the ECB would feel reassured and could tackle the problem of financial stability on the short term along two lines: more intense support for the government bond markets and particularly restarting the old formula of unlimited financing for the banks of the euro area

in the expectation that those banks might eventually (inaudible) the bonds themselves exactly along the lines of the former, the first, informal grand bargain enacted in May 2009 to the benefit of the French and German banks.

Well, let me see the events of the past weeks in this perspective. While the political lack of the solution is very well advanced, political credibility has been restored in the critical countries. And economic and fiscal measures are being adopted. The longer term fiscal commitments are the core of the new policies. And commitments to balance the budgets will be introduced in the primary legislation.

As to the financial rescue funds, we will see in July 2012 a new stability mechanism with 500 billion euros of firepower probably in the hands by a leverage of 2-to-1 trillion. And most importantly, this stability mechanism will have a capital made of joint and several guarantees. What I mean is that the core principle of a fiscal union -- that is once you put the money together, the capital belongs no more to the single nations, but to the euro area together -- has already been established. My understanding is that the train for the European fiscal union has left the station and that Europe in 2013, if it will survive, it will have a fiscal union.

So is 2013 or even mid-2012 too far? Yes, it is. As I had promised there was a limit to my counterintuitive approach.

Why are we waiting so long? Basically the reason is a wrong analysis of the causes of the crisis. Especially in Germany, they focus on the fiscal profligacy of some single countries. And once you have a single simple and wrong explanation, you think that the process toward the solution is of a linear kind and that you will be bound to approach it with a course of time. Unfortunately, what we see is that the crisis moves along nonlinear mechanisms. Contagion is nonlinear; multiple equilibria, by definition nonlinear; and changes of regime as well. So we have the risk, we face the risk of further

nonlinear events in the course of the next months.

And how can we counter this situation? Well, basically what comes to help is the last and very important component of the package of last week, which is the unlimited liquidity provided by the ECB to the euro area banks. Having unlimited financing for three years at a maximum cost of 1 percent opens a significant trade opportunity against Italian and Spanish bonds, ending around 20 percent in the 3 years and being backed up by the European stability mechanism. I cannot pretend the markets can be attracted as I am by the political meaningfulness of the European project, but I suspect that they will be attracted by their own interests and that they will be ready to seize the opportunity.

MR. ELLIOTT: Thank you. Domenico.

MR. LOMBARDI: Thank you, Doug. Let me first say that I think this summit that we had last week was important in the sense that it finally delivered a strategy or at least a strategy appears to be emerging, which was not necessarily the case of many summits we had before. This strategy seems to be articulated around three lines of defense.

There is a first line of defense which essentially relies on corrective budgetary measures to be implemented by euro area member states under the stepped-up surveillance of the European Commission and in a context of a more credible sanctionary regime. It also embeds a deflationary type of adjustment that, however, over time, may erode the political support for the euro.

Some of the countries, for instance one of the countries I'm most familiar with, Italy, I believe I've already delivered substantially the decree that the new cabinet led by Mario Monti has put in place will entail an adjustment of -1.8 percentage points over the GDP for each year from now to 2014. This adjustment clearly comes on top of

the adjustment already entailed in the two budget supplementary laws that were put forward by the previous government over the previous few months. And yet we have a kind of, you know, asymmetric sharing of the burden in the sense that all the burden, all the risks are essentially put on the debtor countries with very little mutualization of risk, which is, I believe, a necessary requirement for the sustainability of a currency union. Just to make a concrete example, while the surveillance has been considerably stepped up, the sanctioning regime has been considerably enhanced. The debtor countries, especially the big debtor like Italy, has taken unprecedeted steps, yet we have not seen anything, you know, corresponding sort of size or quality of commitment coming from the creditor countries in the euro area.

So I was saying the first line of defense relies on national member states. And there is a big symmetry here in terms of the burden, of the distribution of risk, but I'll come back to that.

The second line of defense is the financial firewall that would be set up through enhancing regional financial mechanisms and the IMF. In that regard my reading of the establishment of the ESM, the new permanent regional financial mechanism, is that those resources will not be additional to the resources that the EFSF can deploy. And, therefore, you know, it's something that perhaps should be emphasized and I have not read a lot about this in the press. But, again, there is no additional resources.

And then there is the IMF. By entertaining the idea of providing a loan to the IMF under the GRA -- the general resources account -- the euro area and the European countries are essentially, you know, transferring the risk, the risk that cannot be borne by the debtor countries on the IMF membership and through the GRA because clearly any risk on GRA resources would be borne by, you know, the institution and the IMF membership.

And then there is the third line of defense. That is the role of the ECB. And the idea is, of course, that the ECB, as has already been pointed out by previous speakers, would hopefully step up, removing any residual systemic pressure that the two previous lines of defense would be unable to manage. And clearly that's not, you know, necessarily a lender of last resort role as many times it is argued, but it is more a kind of stabilizing role that the ECB would perhaps be more comfortable in doing if, you know, there were stricter budget disciplines, maybe certified by the IMF by extending programs to Italy and Spain.

Just if I have time, Doug, just a couple of more points on the issue of the IMF and how -- what kind of a role, you know, that could be playing. Clearly if this firewall has to be erected, it's clear that the IMF should be able to extend programs to Italy and Spain simultaneously. This, of course, creates, you know, a potentially huge financial burden for the institution whose balance sheet is not well equipped to handle programs with larger sovereigns.

Just to give you an example, for the next 2 years Italy and Spain will be issuing something like, you know, in excess of 560 billion euros. And then if add another 200 billion euros to refinance the banking system -- and this was a figure that was put forward by the IMF in September, I believe -- and we allow for further room, you know, to refinance some of the peripheral economies and so on, we end up with a total amount a little bit short of 1 trillion euros. If the EFSF, ESM has a residual and net lending capacity around 300 billion euros, it's not really clear where the residual 600 billion euros would be coming from. The assumption emerging from the summit is that the Europeans will be putting 200 billion euros in the hope that this will catalyze an additional 200 billion euros. So we have another -- we have a gap of 200 billion euros that would be maybe expected by the Europeans to be put on the table by the IMF, maybe through an activation of the

residual amount of the NAB, the contingent facility that has not been activated so far.

But this would, of course, leave the institution in a situation of unprecedeted potential distress given that it would be heavily -- you know, the risk would be heavily skewed toward one single region in a way that has really been unprecedeted for the institution. And this is where really the ECB could come in and really try to stabilize, you know, the situation by taking over some of the systemic risk that cannot be simply outsourced, you know, outside of the euro area.

I will stop here. Thank you, Doug.

MR. ELLIOTT: Thank you. Okay, thank you all. I thought that was a very lucid set of views. Obviously some significant difference among them.

It seems to me it would make sense first to let Antonio respond, particularly I would expect to Desmond's comments. I assume you have a few things you'd like to say.

MR. DE LECEA: Yes, thank you, very briefly. I mean, I think that some of the -- I mean, while I can understand the assessment and some of the economic rationale is very much based on the textbook or on some past policies of the Fund. But I cannot always -- I mean, I cannot agree with some of the other mystic figures that you point out. I mean, the firewall of 2 trillion, come on. I think I would like to see how you reach that figure. It's under assumptions that are really brave and, frankly, doubtful.

So the issue -- where I would agree, for once, is on the issue of the consequence or the impact of fiscal retrenchment. And two points there.

I mean, one is that we are aware that fiscal contraction, indeed, detracts demand and may fuel deflation and recession. I mean, the point that I would like to underline there is that it is -- I mean, that we're aware, but that the fiscal solution or the fiscal approach, as I said, is not the only one. And especially in some countries the

programs that have been agreed has a fiscal contraction aspect, but have, at least as importantly, a growth enhancement aspect with a number of structural reforms that if only a few of them are implemented vigorously, they will generate growth and they will generate growth that offsets some or all of the impact of fiscal retrenchment.

The second point that I would like to make on the issue of fiscal austerity is that as I hinted earlier, I mean, fiscal austerity or the capacity to rein in public finances is a signal of the capacity of governments to really deliver and to address more difficult problems which are those of growth. If governments cannot cope with deficits, it is more difficult that they will be able to cope with promoting growth. So it has been taken as a kind of litmus test of the capacity to deliver and, therefore, it has been given priority.

But our approach is a two-pronged approach. Certainly fiscal discipline because it's necessary. Because, I mean, the increase in public sectors and the increase in deficits that we have seen in the past had to be addressed vigorously and with plenty of discipline, but, at the same time, we are all aware that this was only part of the solution and that we cannot only focus on that one.

MR. ELLIOTT: Let me ask you one other question, Antonio, which is I think the thing I personally worry most about is what happens in the next three to nine months? As Desmond has pointed out, the markets didn't receive this with great enthusiasm. There are many, many things that could go wrong. It seems to me quite possible the markets would become very spooked in that shorter term period and Italy or Spain might be unable to borrow temporarily and the other would immediately find itself in the same situation. So there would be a need for at least the availability of very large amounts of public funds.

I wonder if you could just comment about what could be done in the relatively short run if the worst occurs.

MR. DE LECEA: Well, the question is fully legitimate and the answer that you can expect is that the combination of the current firewall, the European firewall, plus what we expected the IMF can do, together with some implication of the ECB can address the various parts of that problem, that is the financial part of the -- I mean, the banking sector part of it and the sovereign part of it. So with the ECB addressing more the banking liquidity aspect and the official firewalls, the sovereign one. And in this respect, I mean, assuming that in case those two countries or one of those two countries needs assistance, that this country is going to be out of -- I mean, it's going to be impossible for that market -- for that country to address the market for a long period is a brave leap of faith. Unlike Greece, where the economy was indeed in a very, very dire situation and the solvency problem was there, this is clearly not the case for Italy whose economy is very strong. And it's not the case for Spain either, where the fiscal room is much higher. I'll remind you that the debt level, the official debt level, of Spain is below 70 percent. So, I mean, there is room for maneuver, if necessary.

So the situation, as I said, of the two countries is completely different to that of Greece. Therefore, we don't need the same degree of mix of markets and on market instruments, so the amounts that would be needed would certainly not be of the order of magnitude that have been quoted earlier this evening.

MR. ELLIOTT: Okay. I'm not perhaps personally as optimistic as you are, but let me go to Desmond for a moment who's definitely not as optimistic.

MR. LACHMAN: I'd like to couch the discussion not in optimism and pessimism, but in being right or wrong or realistic or being on another planet. (Laughter)

MR. ELLIOTT: I'll stick with optimism and pessimism, if you don't mind.  
(Laughter)

So I have a couple of questions for you, Desmond. First, I do think it's

an interesting question, the 2 trillion euros, can you talk a little bit about how you come to that figure?

MR. LACHMAN: Surely. You know that you can come at it in a variety of ways. You just need to look at the size of the public debt of the countries in the euro -- the countries in the periphery. You know, if you just look at Italy alone, the stock of Italy's public debt is around about 1.9 trillion euro, that if you look at all of the countries involved, you're looking at 3.7 trillion euro. You're talking about really very big numbers.

If you wanted to look at it in another way, Italy's financing needs over the next 2 years, that is roll over its debt and its small budget deficit, that totals like 300 billion euro in both 2012 and 2013. So Italy alone might need an IMF program of the order of something like 600 billion euro if we follow the same path that we did for Greece, Ireland, and Portugal; take them out of the market for 2 years.

Just on that point what I as an American taxpayer am a little bit concerned about is what the Europeans are doing is that they're proposing to loan 200 billion euros to the IMF and get a claim on the IMF. The IMF then happily goes and lends money to Italy. As a shareholder, the United States is on the hook for 70-1/2 percent of that loan. So they're really using United States -- they're putting United States taxpayers' money at risk through this kind of operation. I think that strikes me as a little bit much, you know, that the Europeans have got the dough, they should do it themselves. They shouldn't be using the IMF to do it.

But just the last point because this is really the important -- the whole thing comes down to do these policies make sense from the point of view of avoiding a deep recession? I don't think that one can talk about this qualitatively if you've got fiscal retrenchment of the order of magnitudes that we're talking about. Domenico mentioned for Italy, which is one of the countries that has got the least amount of fiscal adjustment to

do, nonetheless it's 2 full points of GDP in the next 2 or 3 years. It's having to do that at the same time that we've seen institutional investors have pulled out 12 percent of their deposits from the Italian banking system. There's a real credit crunch going on at the same time. The country's already moving into recession. And its partners are now not giving it a good environment. If that doesn't produce a deep recession, I'm going to give my certificate of graduation back to my alma mater for what it was worth. It just happens to be the place where John Maynard Keynes hung around. (Laughter)

MR. ELLIOTT: So let me ask you one other question, Desmond, before we move on. Clearly a very strong and implicit, and perhaps even explicit, part of your analysis is an assumption that the number of the periphery area countries are basically insolvent as opposed to illiquid or having to go through a more modest adjustment process that doesn't involve default. Could you talk a little bit about how you come to that conclusion and about which countries you actually think are insolvent?

MR. LACHMAN: Well, the one that goes without saying is Greece, where the IMF's own estimates are saying that Greece's debt-to-GDP level is going to go up to 190 percent. You know, it's obvious that the country has to --

MR. ELLIOTT: I think we can take Greece as red (phonetic).

MR. LACHMAN: No, but I think that the others, if you've got to do fiscal adjustment of that sort that is going to produce a recession, that is then going to require additional fiscal measures, and where you've got political backlashes against that, you're just not going to be able to do that. Politically you're not going to be able to deliver. If you want to go the Latvia route and have your output drop by 20 percent and the population puts up with it, then it's doable. What I'm saying is that the magnitude of fiscal adjustment that is being required of these countries to be sustained over many years if politically not doable, and that what you're really needing to do is recognize that and have

some sort of debt write-down minimally.

I would think, though, that essentially what the IMF is offering a lot of these countries is it's offering these countries more depression for a long period of time. It's offering them a lost decade that many of these countries would be better served -- and I'm talking about certainly Greece, Portugal, probably Ireland as well -- they'd be better served to exit the euro because that's where they're going in the end. And life after exiting a fixed exchange rate arrangement of this is not as bleak as some are painting out. Some of us have got experience with Argentina, which had a rather good decade after it got out of its convertibility plan.

MR. ELLIOTT: Before we end that, I notice you didn't take me up on the question of which countries you think are insolvent at this point.

MR. LACHMAN: Well, I think that there's a different question, you know, that, for instance, if I look at Spain, I think that what you've got to do is you've got to look at these countries not simply through the lens of public finances, but you've got to look at it through the lens of overall public indebtedness and overall external indebtedness. When I look at a country like Spain, what Spain did is they went on a massive borrowing spree abroad to finance a housing bubble that was larger than that in the United States. So basically what Spain has to do is it's got to deflate its economy in order to get it back on track, and that is similarly a problem that is not sustainable from a long point of view.

So I would say that I don't see how Spain is going to manage to do this, particularly in the kind of environment that we're going to have. Because what is going to occur is that when Greece defaults -- and we won't need to wait too long for that to happen; that is certainly going to happen the next six months contrary to what Carlo says -- the person who's going to be replacing Papademos, Samaras, isn't too keen on fiscal austerity. When you get that, you know, what you're going to have is you're going to

have a lot of knock-on effects on the banks. You're going to get the credit drying up. You're going to have a banking crisis. Then you get an external environment that makes it really very difficult. Countries that formerly would have been solvent then lose their solvency.

MR. ELLIOTT: And what about Italy?

MR. LACHMAN: Italy, I think, needs a debt write-down. You know, just the debt dynamics just doesn't make sense, you know, particularly if the market's lending them money at 7 percent, you know, you just look at the debt dynamics. Italy needs a primary surplus at these kinds of interest rates. Italy needs a primary surplus of 5, 6 percentage points of GDP. It's got a current surplus, a very small primary surplus. It means there's 6 points of fiscal adjustment. I'm not sure that you can do it, particularly in an environment that's not good. You know, you're going to have to accept that that debt needs to written down.

MR. ELLIOTT: Okay, let me give a chance to the other two. Carlo, I know you wanted to jump in and then I'll give a chance to -- I'm sorry, Domenico and then Carlo. Go ahead.

MR. LOMBARDI: Yeah, just on this issue of, you know, the envelope of resources, maybe I am a little bit cheap, but, you know, I came out with an estimate of in excess of 1 trillion. And clearly, you know, you can add it up.

But, you know, regardless of the amount of resources, whether it's 1 trillion or 2, clearly one should disentangle the issue of calling for support from the international community in terms of providing additional financing, to relax the financial constraint that the euro area has at the moment because there is, undoubtedly, a financial constraint. But this issue should be disentangled from the issue of, you know, the distribution of risk. You cannot, you know, allocate the risk to somebody else and,

you know, at the same time, requiring, you know, more support from the international community.

So just to give a concrete example, it is obvious that if the BRIC countries are willing to provide additional supplementary resources to the IMF, those countries will be requesting some sort of, you know, type of guarantee that would be coming, you know, from the IMF through the GRA resources. But what I don't really understand is how, you know, euro area nations' central banks can hope to reallocate this risk, you know, away from the euro area and in turn expect that by doing so this is going to catalyze as many resources from the rest of the international community as they're putting on the table. And, therefore, you know, if the euro area wants to leverage more on resources from outside the euro area, it should also be able to offer a kind of risk profile, a risk package, that looks a little bit more attractive, perhaps with the ECB explicitly or implicitly stepping in and, you know, take some of the residual risk. I think this is also what many IMF shareholders are waiting for.

MR. ELLIOTT: Okay. Why don't I give you about two minutes, Carlo, and then we'll go to the audience?

MR. BASTASIN: Well, I must admit I'm slightly surprised by the kind of economic analysis behind the conclusions I've heard. If I see the figures and if everybody looks at the figures regarding Ireland and Portugal sees a completely different sign from what happens in Greece, and the reason is that applying the Greek case to the other countries is wrong on a factual basis and on a theoretical basis. As economists we've been going through a couple of decades discussing known Keynesian (phonetic) effects of fiscal austerity or Keynesian effects, disregarding the fact that they change radically depending on the fact that you're talking about: an open economy or a closed economy. Greece is a closed economy. Eighty-five percent of the profits of firms, of

Greek firms, comes from the domestic market. When you force too much austerity, cut wages, you cut demand, you cut expected profits and investments, and you create a spiral of recession. As it happened, it was the wrong medicine.

It's something different if you force some austerity in Ireland, where 85 percent of the profits come from outside. And indeed, Ireland is recovering, Portugal is stabilizing. As to Italy and the insustainability of primary surpluses, just remember that in the 10 years from the onset of the euro, the nominal value of the primary surpluses accumulated by Italy is equivalent to those of Germany, France, and Spain together, so it is possible. In the next year the public debt in Italy will decline, the supply of government bonds will decline, and they are still offered at 6 percent or even 7 percent, which is deemed a sustainable level for 2 or 3 years from the Bank for International Settlements or from anybody which knows algebra well enough.

For the rest, it's obviously and legitimate to discuss about the burden for the taxpayers in their country and it's helpful to do that. But in a way, if we see the story of the last years, if we had to discuss about the burden of taxpayers in each single country, we will come to the wrong conclusion. In 2011, Italy was expected to have for the first time in a couple of decades its public debt plunging under the threshold of 100 percent of GDP after having been at 126 percent at its maximum level. It's now at 120, not because of its own problems, but because of the crisis which began in 2007 and 2008 elsewhere. But it's not sound, it's not healthy to reason in terms of known interdependency of our countries, I think.

MR. ELLIOTT: Okay. Thank you all. So let's take some questions from the audience. I think we'll take two or three at a time and then go through in batches.

So we do have microphones coming. I think there's a person right there.  
Yeah.

MR. TALLEY: Ian Talley, Dow Jones, *The Wall Street Journal* Bureau. The discussion in the euro zone statement of the 200 billion didn't clearly specify that it was going to go into the general resources account. And the U.S. and Brazil and I think perhaps a number of other countries have said they preferred an administered account, which would go to the issue of how those funds are -- what sort of risk exposure the IMF has and how they're used, et cetera.

Where do you think the nature of that discussion is? Will it end up emphatically on the GRA because Bundesbank won't loan unless it goes to the general resources? Will the U.S. and Brazil be able to enforce their perspective?

And then just separately on a slightly different note, there was an interesting note in the last World Economic Outlook that a 1 percent decline in Italy's growth rate would yield a 20 percent increase in their debt-to-GDP ratio. This is the IMF saying this. And if we're potentially heading into a recession for Italy, then aren't the numbers we're talking about to the debt-to-GDP ratio really not correct?

MR. ELLIOTT: Okay. How about Teresa (phonetic) up here?

SPEAKER: I'm Teresa (inaudible). I'm formerly from the IMF. Well, the first question that I had was exactly what has just been raised, so I will skip it.

I agree with Domenico that this looks like a somewhat imbalanced approach in terms of symmetry of adjustment, and that really the creditor countries are not making any contribution, including through a more expansionary fiscal policy and through structural measures of their own to improve the prospect for growth in the euro area as a whole. So my question to Antonio is, are there any signals that you know of that could give us some reassurances that Germany's not there just to ask for more and more adjustment from the other countries, but prepared to help the adjustment of the euro area as a whole?

And second, can you be a bit more specific on what kind of structural measures can, you know, boost growth and are being considered to boost growth in the - - you know, particularly in the debtor countries? And how soon can such measures be expected to, you know, compensate for the obvious recessionary effect of the fiscal restraint and of the credit crunch?

MR. ELLIOTT: Okay. And the gentleman here, and then we'll let them answer this set of questions.

MR. HERRIOT: Judd Herriot (phonetic), documentary filmmaker. I had the same question on what structural measures could be used outside of the exchange rate regime to promote growth.

But I believe yesterday Angela Merkel made a speech in which she said this is going to be a long-term process, an adjustment, solving these problems. And of course we know that the British backed off completely. I'd like to ask you what impact this is going to be have on what you've been talking about.

MR. ELLIOTT: Okay. Why don't we start with Antonio since a number of them seem directed to you?

MR. DE LECEA: On the first point of the IMF, the loans to the IMF, well, all I can tell you is that discussions are going on on the modalities of those loans -- I mean, on the amounts, the European countries and we think other international partners, and on the modalities. So I think I'm not in a position to say more on whether it will be the general account or an administrative account. My understanding is that it is the general account precisely because it was considered more adequate by some of the other lenders rather than a trust fund or a special account. But, I mean, I cannot go any farther.

On the issue of the imbalance or the asymmetry between debtor and

creditor countries, well, if we look at the demand increase and the increase in wages in some of the creditor countries, in Germany or the Netherlands, we see that there is some improvement. Therefore, that there is an increased demand that comes from the current approach.

If you ask me whether we can contemplate much more than that, I'm not sure. Given the recent discussions it would be beneficial, but I'm not extremely confident in this respect, to be frank.

On the type of structural measures that we believe can unlock growth, well, in a country like Greece or maybe in regards to Italy, Carlo or Domenico may be more explicit, but, I mean, take Greece. I mean, the extent of the public sector enterprise, the state-owned enterprises, was very, very, very high. These firms were non-efficient and were also loss-making. So the approach of both privatizing and of removing some of the licensing and other restrictions to product markets and also to labor markets will certainly improve not only the unit labor costs, but also the competitiveness of these enterprises and will -- I mean, sooner rather than later -- contribute to growth rather than detract from it and detract from the sustainability of public finance.

So the opening of closed professions, all that was much more important in Greece than what we can think of some of the other economies. So, again, just unlocking and promoting competition will drive down costs and will increase efficiency.

So, I mean, the crowding out effect of public employment, I mean, public employment was not only big, but the salaries and wages were much higher in some sectors of the public sector than the private sector. We think under those conditions no private sector can really thrive. So rebalancing both the wages and salaries and also taxation can promote the right incentives to growth. So these are just some of the

examples that we believe that can unlock growth and, as I said, sooner rather than later.

And in Italy, I mean, there is a long package of measures that have been agreed. We know that it will be a long process.

As regards to the UK, we hope that the UK will come to -- I mean, back to the same path as the 26 others pretty soon. I think we believe that the conditions are there. But in any case, the UK has already opted out of the euro and most of the measures that we have agreed now are for the euro. So the need of the UK is really to have more cohesion and to avoid some of the administrative hurdles or legal hurdles of having to play with two different frameworks at the same time. But, I mean, in itself it is not a hindrance to the applying what has been agreed so far.

But once more, I mean, we believe that the conditions may be there for the UK to rejoin the others pretty soon.

MR. ELLIOTT: Who else would like to answer the questions? Desmond.

MR. LACHMAN: Just the question raised about the various central banks in Europe and the IMF. That's really a very tricky question. If it goes through the general resource account, you're going to get Britain and the United States complaining. If, on the other hand, they put it through the administered account, you're not giving them the fig leaf that the loans are to support the international monetary system as opposed to bail out the countries involved. You know, then you've got the Germans getting excited about the legal strictures of the Treaty of Lisbon, that you can't bail out countries with Central Bank money. So you've already got a really very thorny issue there. I don't think that the Europeans can live without going through the general resource account, but hopefully the United States won't go along with that.

Teresa's point is obviously the correct point, you know, that you can't have everybody tightening at the same time, tightening their belts. You've got to have

the surplus countries making room for the deficit countries to do the adjustment. And that's, you know, part of the reason that I think that it makes no sense.

Just in terms of structural measures, structural measures are great. You know, they produce growth in the long run. They put countries on a different growth path. But generally structural measures that are going to be very effective often involve firing people, reducing the wages, rationalizing, and all of that isn't too good when your economy's in a recession that really doesn't do much for domestic demand.

The last thing, just when Ms. Merkel talks about the marathon that this is going to be, she forgets that the Greek who actually ran the marathon died at the end, you know. So maybe it's a metaphor.

MR. ELLIOTT: Yeah. Domenico, you had a comment?

MR. LOMBARDI: Yeah, just following up on Ian's question on the resources that the euro area central banks would be providing to the IMF. Really, you know, from a technical viewpoint it's a matter whether they should go to the GRA or to the administered account, as Desmond has pointed out. But, you know, aside from the technical aspects, which are also important when you deal with European issues, but aside from this aspect, I think again it really boils down to how much risk the Germans are willing to take or not. And clearly, you know, if they were to opt for the GRA option, it will be very difficult for the Europeans to catalyze resources from the others, from the non-Europeans.

If they were willing to show some more, you know, risk-taking, I think that would pay off in terms of more good willingness coming from the rest of the IMF membership. But in any case, these are issues, if I can make a little plug, that with the co-authors, (inaudible), we have elaborated in a paper on conventional IMF interventions that will be available tomorrow evening on the Brookings and Foreign Policy websites.

MR. ELLIOTT: Yeah, and if you want to just stay here and wait for that paper, we'll be happy to put out some sandwiches, et cetera, for everyone. (Laughter)

Yeah, Carlo, if you don't mind, I think we might try some more questions.

Okay. Yeah, there's a question about the middle back there.

SPEAKER: Hello, *mes amis*, from the Greek main opposition party. I would like to ask a question.

In Greece, we're looking at a very bad situation, as you can tell, but we don't want to exit the euro zone. That is a certainty for the majority of the population. And we also cannot take any more austerity measures because they're absolutely killing us. Is there a third way, something you would advise? Perhaps Mr. Lachman would like to answer that, if he had like the Greek finance minister in front of him, what he would advise.

MR. ELLIOTT: Okay. And before you do that, Desmond, we have a question up here as well, the fellow in the blue there. No, no, sorry. There is a lot of blue out there.

MR. BLEDOWSKI: Kris Bledowski from Manufacturers Alliance. I'd like to come back to the issue that Carlo raised, and that is that with the lower cost of capital now provided by the ECB for liquidity purposes for the securities market program, and the lengthening of the maturity, now there's a window of banks plying the carrot trade: borrowing on the cheap and buying the instruments at extremely low prices. Caveat emptor, there's nothing wrong with that depending on what your flavor is and what your risk profile is. But my worries, and this is basically my question, is in Europe there's a tricky relationship between banks and governments whereby very often banks are sometimes even extensions of governments in terms of balance sheets. So if these banks who are notionally independent would be under pressure, moral suasion from the

governments to engage in these types of activities, we're talking about shareholder money being put at risk and a lot of that shareholder money are regular taxpayers whose pension funds and other savings are tied up in it.

So are we talking about a risk here and a moral hazard coming out of the moral suasion down the wrong way?

MR. ELLIOTT: Okay. Why don't we handle those? Desmond, you might as well start. I know you have ideas on Greece. And then we'll cover the other question.

MR. LACHMAN: Obviously the Greek situation is very difficult and you can't present it as Greece having good options. What Greece has to choose is between a bad option and a worse option. And what I'm saying is that the IMF's/EU's approach of fiscal tightening to try to deal with this problem means that the Greek depression is going to get deeper, that there's going to be no prospect of Greece ever getting out of this, so Greece in the end is going to default and is going to exit the euro. I would think that the earlier that it does it, the better.

I would just qualify that, though, in saying that exiting the euro is not an easy option. If you're going to exit the euro, you've got to do it successfully. It's going to involve the same sort of fiscal adjustment as before, but at least you'd have a chance. If you go that route, you can mess that up, you know, so it's not easy. It's got to be done properly with proper adjustment measures, preferably supported by the international community that then gives you a chance.

I'm just saying that what the IMF and EU are offering Greece is a lost decade, a really very bad lost decade. I would say on those circumstances, you've really got to give the other option a shot, but you've got to understand that it's not an easy road.

MR. ELLIOTT: Okay. Antonio, would you like to comment on either of

the questions? And then I'll give Carlo a chance since we didn't.

If you'll hold off one moment, Carlo, I thought I'd give Antonio a chance.

MR. DE LECEA: No, I mean, on the case of Greece, well, I cannot say that there are miracle recipes. Indeed, the situation is dire, but what I can say is that the alternative of exiting the euro, as proposed by Desmond, doesn't solve the problems. So it doesn't solve the competitiveness problem. It can be -- I mean, this problem can also be solved in the way that it is now proposed by reduction even in nominal wages. And it is (inaudible) a reduction of unit labor costs more and more competitiveness so that the companies can become -- I mean, more competition so that companies can become more competitive and, therefore, gain competitiveness abroad. And it doesn't solve the fiscal problem either.

So, I mean, you get the political problems. You don't get the economic benefits. So it's not the panacea that seems to be presented. So, unfortunately, I cannot offer any other recipe than the one that has been proposed by the EU with the IMF. But what I can tell you is that what we have seen of the alternatives are not so.

As regards to the effect that the increased ECB liquidity can have on the possibility of banks (inaudible) rate, well, that's a way that is pointed out by some that could help the financing sovereigns through banks indirectly.

The reference to -- I mean, the question that you raised about whether more or less the long hands of the state in some countries can bring a moral hazard, well, this is decreasingly so. And the (inaudible) state sector in the European economies has decreased substantially in the last few years. So I don't see this problem of just sweeping under the carpet and having other -- I mean, half state-owned enterprises or banks taking the risk that would be otherwise.

MR. ELLIOTT: Carlo?

MR. BASTASIN: Well, I have a slightly different vision about a very well put question about the banks. Actually easy financing for the banking systems has been provided at several stages during a crisis which has already reached the fourth year. So our first case was in May 2009, when a first operation with very low interest rates and unlimited allotment, full allotment, was provided by the ECB to other operations with different interest rates who were done in the course of the year. And what we saw was that at the end of the year, the banks had undescribed (phonetic) up to 70 percent of the new debt issued by the governments that year. Was it a work of moral suasion? Was it a convenience? Well, it's both.

It worked that year pretty well until at the end of 2009 we discovered that Greece had a problem with public accounts and had fudged the account. At a second stage it was try to -- the governments tried to do the same operation and it didn't work in 2010, or it worked only in part.

Is it a concentration of risks on the shoulders of the shareholders? Yes, but the alternative is -- I mean, the risks appear only if you have a default. For instance, if Italian banks buy government bonds, the risks appear only if Italy defaults. So there is practically no reason in terms of alternative. The only reason you have is to calculate if being financed at 1 percent and earning 20 percent in 3 years is a good bargain. The alternative is if you're broken -- you're broken if the state is broken and, as a consequence, you would be broken anyway. So basically that's the point.

MR. ELLIOTT: Okay. And I was going to cut it there, but Domenico has a comment. So if you can keep it to one or two minutes, and then we'll let people go.

MR. LOMBARDI: Sure, very briefly. Just to recap on the, you know, kind of prospect that Greece, but also other countries in the euro area, may have in the coming years, essentially they will have no fiscal room because they will have to

undertake substantial fiscal adjustment. The interest rates at which they will be refinancing their debt for those countries who are going to have access to the market is going to be, under the best scenario, lower than the current levels, but not significantly lower.

The exchange rate for the southern -- the exchange rate for the euro, of course, may be still quite high, especially for countries, you know, in South Europe whose export structure is more sensitive to price competition and, therefore, you know, might be affected more than the northern economies whose export structure is quite different and, therefore, less vulnerable to a high exchange rate.

Inflation, well, clearly if, you know, the inflation target were to be higher, the adjustment would be easier to implement, but I don't think this is going to be the case. So under the best scenario there will be really, you know, tough times ahead of us. And I don't think that any summit has still taken, you know, those challenges yet. Thank you.

MR. ELLIOTT: Okay. Thank you all for coming and I think we should thank what I thought was an excellent panel. Thank you. (Applause)

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