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P R O C E E D I N G S

MR. ELLIOTT: Good afternoon everyone. And thank you for joining us today. It's truly both an honor and a pleasure to introduce Andreas Dombret, who is on the executive board of the Bundesbank. You have his bio, so I won't go into it in detail. But he had a quite distinguished career in the private sector in investment banking prior to his present position. And we actually overlapped at J.P. Morgan. We were colleagues there. So it's a particular pleasure to introduce him. His comments will be self-explanatory, so I'm not going to try to, to try to set them up. The way we're going to do this is Andreas will speak. When he finishes, he and I will sit up here and I'll ask him a few follow on questions. And then we'll turn it over to you in the audience to ask your questions for him to answer as he pleases. So, Andreas.

MR. DOMBRET: Thank you very much, Doug, and it's also, but only because we have been colleagues, a pleasure to me to be here today on a sunny day in a room with some windows, but no sun. And I thank you very much for having me here today and I'm trying, I will try not to bore you, but to speak as precisely as I can. And for me, it's my first time that I speak at Brookings. I have spoken at other institutes, which of course, I cannot mention here. And so it's a privilege, you know to be at such a distinguished institution.

And I don't need to tell the people over here today, because they know why they're coming, that for almost a century now, this institute, this Brookings Institute, long before you joined, by the way, Doug, has provided essential analytical input. And this input is important for policy makers around the world, and these policy makers of course include the Bundesbank and other central banks.

And I would like to begin my speech and I owe it to Doug that it's a little bit personal with the Bundesbank and I would like to refer to the first week in office of myself, because I started working in office on May 3, 2010. And as you can imagine, I remember quite vividly the time, because it was a decisive week for me because I started working at the Bundesbank. But at the same time, it was a decisive week for the Euro area and everybody who was thinking about the Euro area knows how important May 3rd of 2010 was.

On, because basically, on the day before May 3rd, on May 2nd of 2010, the EU Finance ministers agreed to support stumbling Greece, if you think back, actually with a 110 billion Euro rescue package. We have become used to large numbers. But at the time in 2010, it was an especially large number, 110 billion Euros.

And one week later, well into my term, so to say, on May 10, the European Central Bank then decided to buy government bonds in order to stabilize the financial markets. A decision which some of you may know the Bundesbank has criticized. Now, looking back, no one can deny that this was week in May of 2010 was kind of a turbulent one. To many, it even counts as the official start of the Euro crisis. And to me, it was a time when two things became obvious, which is kind of important to me.

First, many observers from outside Europe and I especially mean the Americans, also probably the ones here in the room, so notably observers from the United States underestimated, underestimated the political will in Europe to hold the Euro area together. And second, many observers from inside Europe, including myself, actually, we overestimated the stability of the institutional framework of the monetary union.

Now, what is the logical conclusion of these two insights? The conclusion is that we have to advantage of the apparent political will in order to then improve the institutional framework of the Euro area. But how can this be done. And I'd like to give you my opinion about that.

In my view, and it's also the view of my colleagues on the board of the Bundesbank, the overarching theme in this regard is integration in Europe. To be sure, Europe's political landscape actually now features a number of parties, of political parties that are riding a wave of Euro skepticism and anti-European rhetoric.

And this is certainly a somewhat disturbing development. Nevertheless, political leaders and the majority of the people throughout Europe are still very much convinced that the idea of a unified Europe is the right idea to have. And from an economic point of view, a view I would like to concentrate on, deeper integration could help strengthen the framework of the European Monetary Union.

So let us take a look at three areas, at three areas where further integration could be the way forward. The first area is public finances. And in order to fully understand the core of my argument, it is important to be familiar with the particular features of the European Monetary Union. Not, maybe not all of you, 100 percent familiar with those features.

The European Monetary Union is special, is very special, in that it combines a single monetary policy with national, fiscal policies. The monetary policy for the 18 countries of the Euro area, as you know, is decided by the governing council of the European Central Bank in Frankfurt. However, the fiscal policies of the 18 Euro area member states are a matter for the national policy makers.

Just to remind everybody, each country decides on its own government revenues and expenditures in Europe. Now this imbalance, this imbalance of responsibilities actually give, gives individual countries an incentive to borrow. And economists would call this a deficit bias, which is being introduced into the Euro area system.

Our objective should be to counter that deficit bias to ensure a stable monetary union. This can only be achieved by realigning responsibilities and as we in the Bundesbank keep on saying, liability and control have to be in balance. Now, one way to rebalance liability and control is deeper integration, I would like talk about today.

If we were take this path, the European level would gain certain control rights over national budgets. And this would amount to what is known as a fiscal union, something the United States of America, of course, have. However, such a step in Europe would depend on the countries of the Euro area to transfer national sovereignty to the European level. For example, this could be done by giving the European level the right to intervene in the event of unsound public finances.

Now, giving up sovereignty in this way would be a rather radical change, kind of a radical change and we, it would also require wide ranging legislative changes, both nationally as well as on the European level. And more than anything such changes would need the support not only of policy makers, but I'm very convinced also of the general public.

And on this point, I think we need to be realistic, actually I cannot identify any willingness to do that at present in Europe. By the way, not in Germany or any other country of the Euro area, so this means that for the foreseeable future, I would argue control of fiscal policy in Europe will remain at the national level. It is not really realistic to think that this will go to the European level.

Thus, in this area, deeper integration is beyond the horizon. It's not something we can bet on in the near future. But if the current state of lopsided integration prevails, the national level must assume – that's very important, the national level must assume liability for its policies. And that would mean strengthening the current set of rules on borrowing, and by that, I mean strengthening what we call the stability and growth effect.

These rules of stability and growth effect have since been tightened. Now they have to be applied and they have to be complied with. This framework is supplemented by a permanent crisis resolution mechanism, such as the European Stability Mechanism, ESM in short, European Stability Mechanism, which has been established in 2012. The objective, let, let us all remind about this. The objective of the ESM is to be able to counter severe risks to financial stability in the Euro area. And actually, as you know, the ESM was used several times.

Now, the effectiveness of the ESM is based on the, on the idea of a strong deterrent. As long as markets believe the ESM to be powerful enough to act in a crisis, they have a lot less incentive to speculate against any Euro area country. The principle is now called into question by an idea by the new president of the European Commission by Jean-Claude Juncker. This idea, he only thought it recently and he suggested using free, unused, so to say ESM funds to finance investments in infrastructure in Europe. In our view, at the Bundesbank, such a step would greatly reduce the effectiveness of the ESM, so we are not very much in favor of this suggestion.

In a way, the discussion about liability and control relates, of course, to monetary policy. The governing council of the ECB recently decided to buy asset backed securities. This decision actually represents a far reaching change in the monetary policy of the European Central Bank. The objective is not just to boost lending. It is also now to directly pump money into the economy.

Now, the effect of this measure would be to transfer credit risks, actually credit risks that were taken by private banks, to the Central Bank, and ultimately to the taxpayer. If this should happen without an adequate compensation for the risks, we would have another specific policy measure that increases the imbalance between liability and control. Bank owners would not be responsible for their credit decisions. Instead, the tax payers would once again, foot the bill. And this contradicts, by the way, nearly all G20 initiatives that are currently underway.

Ladies and gentlemen, at this point in time, a fiscal union remains more of a vision than a concrete step to be taken any time soon, I think. However, in another area, in a second area, Europe is about to take a significant step to its deeper integration and less than a month from today, the European Central Bank will assume direct supervision of the 120 largest banks in the Euro area, and thereby erecting the first pillar of a European banking union. Now we’re going from monetary union to banking union.

The 120 banks, which will come under the supervision of the ECB account, they’re not that many in number, but they account for more than 80 percent of the aggregated balance sheet of the Euro area banking system. So they are very, very significant. Therefore, the ECB will become one of the world’s largest supervisors, never having done this in the past and they will work very closely together with the national supervisors like ourselves in Germany.

The banking union is certainly, I would think, the biggest step towards financial integration in Europe since the launch of our common currency. And to me, it’s not only the biggest step, it’s also a very logical step to take. Single monetary policy requires integrated financial markets, which includes, at least I don’t have any doubt, European level banking supervision.

Now, European banking supervision will allow banks throughout the Euro area to be supervised according to the same high standards. In addition, cross barter effects can be covered better through joint supervisors than by national supervisors. And adding a European perspective to the national view will put – and that’s kind of important, more distance between the supervisory authority and the entities it actually supervises. And this distance is normally helpful.

All of this will minimize the danger of supervisors getting all too close to their banks and thus treating them with kid gloves, out of national interest, which actually, as we all know, has happened in the past.

Meanwhile, a comprehensive banking union has to comprise more than just an effect European banking supervision. The second pillar of the banking union is a European resolution mechanism to deal with future bank failures. This mechanism will be in place from 2016 onwards. In Germany, we are starting with a law already in 2015.

If push comes to shove and a bank is no longer viable and can no longer go on, shareholders and creditors will now be first in line to bear out the losses of the banks. And taxpayers money will only be the very last resort. Therefore, the European resolution mechanism will of course, also contribute to disentangling the close connection between banks and public finances, which was a central problem in the Euro crisis, as you will remember.

However, one thing should be very clear. We cannot solve all our problems through regulation, as important regulation may be. The banks themselves have to adapt to the challenges they face. One of these challenges is, of course, profitability. Now given the costs of stricter regulation, which we are now facing and the prevailing low interest rate environment in which we are living, many Euro area banks are challenged to remain profitable. Therefore, it is essential that banks first of all recognize their weaknesses and then counteract them at an early stage.

Looking at German banks, which I can judge best, this could be achieved be boosting income in fee and commission business rather than in interest rate bearing business and by taking in consideration cost-cutting measures. There is traditionally a strong branch network of banks in Germany. Streamlining this could reduce, of course, costs. Mergers could also make sense for several credit institutions, with the focus on each case being on the sustainability of each business models.

In any case, the banking union is definitely a major step forward in designing a better framework for the European Monetary Union. However, we should broaden our view beyond the banking sector. A deeper integration of capital markets, which is my third point, would also contribute to sharing opportunities and risks.

To be sure, we have come a long way in integrating capital markets in Europe. According to statistics provided by the BIS, by the Bank of International Settlement in Basel, the claims of European banks within Europe stood at 36 percent of GDP at the end of the 1990s, 36 percent. By 2008, the share had grown to 77 percent. Now this share has again fallen during the crisis. But today still stands at about 48 percent of GDP, so we have been making progress.

However, there are two caveats regarding this trend of capital markets integration in Europe. First, the financing structure of European companies is still predominantly bank based and credit based. A look at the balance sheets of German companies just as an example, shows that bank credit still accounts for about 15 percent of the liability side. This is certainly lower than the 22 percent observed at the end of the 1990s, but compared to the United States and compared to the United Kingdom, there is still a lot of room to increase the share of capital market financing in Europe.

Second, although banks cross border exposure in Europe have increased, integration of capital markets remain incomplete. In the banking sector for instance, integration has concentrated on the interbank market, while credit markets for companies actually remain predominantly national and have not internationalized. The integration of the markets for capital may have increased in Europe but the ownership structure of many companies actually have not, up to now. They are still strongly national.

The relatively low level of integration of Europe capital markets represents a barrier for risk sharing. Equity holdings in the U.S. for instance, are much more widely dispersed throughout the entire country, throughout the entire United States. Therefore, when a negative shocks hits an industry or a specific region, the resulting losses are spread widely beyond that region. In Europe, they are not. Because equity holdings are much more concentrated nationally.

Empirical studies for the United States show that integrated markets for capital cushion around 40 percent of the cyclical fluctuations between the U.S. federal states. A share of around 25 percent is smoothened via the credit markets while fiscal mechanisms cushion just 20 percent of shocks. Now, if you think this is only an American phenomenon, studies for Canada and Sweden come to similar, actually to similar conclusions. Now, having said that two general lines of action could be followed in Europe, I think.

First, it might be beneficial to increase the share of capital markets by the financing structure of companies. This would, of course, require shifting away from the traditional bank based or credit based system, at least to a certain degree. In this context, it might be worth want to take a closer look at the tax regimes, amongst other things. But we all know how important taxes are.

Currently, tax treatment still favors debt financing over equity financing. Removing this bias in taxation would encourage companies to strengthen their equity base and therefore turn more towards capital markets in the search for source of funds. On a side note, strengthening the equity base is also a central issue with regard to banks, as the crisis actually has taught us.

Nevertheless, strengthening the equity base of banks is less a question of providing the right incentives, but rather a question of outright regulatory requirements. And here, we have already come a long way. Now, the second line of action would be to deepen the integration of capital markets, which might eventually result in the formation of a capital markets union.

So I'm coming from monetary union, over banking union to a capital markets union in Europe. To be sure, the concept of a capital markets union is not as clear cut as that of a banking union. No doubt about that. Capital markets are complex, and non-bank finance takes many forms as you know. There could be corporate bonds, there could be private equity, public equity, venture capital or peer to peer lending just to name a few. And I could of course, have a longer list. And integration not just relates to financial products, but also those who are integral parts of their respective markets, such as stocks, stock exchanges and central counter parties.

Therefore, any attempt to form a capital markets union would require a lot of different measures in a lot of different areas. Nevertheless, the idea of a capital markets union has gained some traction. Lately, amongst others, the new president of the European Union, of the European Union Commission, rather, Jean-Claude Juncker and Yves Mersch, member of the board of the European Central Bank. Both have promoted the concept of a capital markets union.

To me, it would be a logical step to supplement the banking union with a capital markets union in Europe. It would reduce fragmentation in European financial markets and at the same time, it would enhance their efficiency and it would enhance their stability. Therefore, it is certainly a goal worthwhile pursuing.

Ladies and gentlemen, I would like to stick to my time. More than 200 years ago, George Washington said that someday, taking its cue from America, Europe would form a united states of Europe. This is certainly a bold vision, which has been voiced repeatedly since the days of George Washington, amongst others, by Winston Churchill, and more recently, by the former vice-president of the European Commission, Viviane Reding.

The vision of a united states of Europe is a very broad approach aiming at encompassing political integration. In my short speech today to you, I have taken a more modest approach, and argued from an economic point of view, as I said at the beginning. I have highlighted three areas where deeper integration might help enhance the stability of the European Monetary Union.

The first area is public finances, although a fiscal union is a rather unrealistic vision at this point in time. The second area is the banking system, and here we are on the eve of a major step towards deeper integration. In November of this year, as you know, on November 4th, the banking union becomes reality. The third area is capital markets. Looking to the future, I consider a capital markets union another project that would contribute to enhancing the stability of the monetary union.

In my view, integration is the way forward, as long as it happens in a balanced way. Not all proposals for deeper integration that are currently discussed actually fulfill this criterion of being balanced. Just take the example of Euro bonds. In essence, Euro bonds would provide a joint guarantee, a joint guarantee for individual sovereign debts. Such a step would increase the imbalance of integration that I mentioned when I discussed the issue of a fiscal union. Therefore, what we need is a, what we need are balanced steps of integration, such as those as I have tried to describe today in my short speech.

To be sure, these are all big steps I described. But in our view at the Bundesbank, they are worth taking. A stable monetary union will eventually benefit every member state. And if every member state is benefiting, this of course, includes Germany. This is a deep belief, actually I hold, a belief that has even grown since my first week at the Bundesbank. Thank you, and if there are any questions after Doug's interrogation, I'm here. Thank you. (Applause)

MR. ELLIOTT: So I think you can probably hear me. In fact, maybe it already has come on. Let me first start by congratulating you Andreas, both on a good speech and on the fact you've clearly adapted to being a central banker. You have managed to put a number of controversial proposals and statements out there in pretty soft language. The ones you were most direct about were expressing serious concerns about the ABS proposal that the European Central Bank seems to quite love. Directly commenting on Juncker's proposal on the ESM and diverting some money to other purposes, you've proposed or implied support for some major taxes changes, closing bank branches, bank mergers.

I'm not going to ask you about any of those. We have a very good crowd here who I think will pick up on the more controversial aspects. But let me start with a really basic question for you. What is the Bundesbank going to do? You don't control the money supply anymore. Many of your bank regulatory roles will be taken over by the ECB. Can you tell us a little bit about what the role is of the Bundesbank going forward?

MR. DOMBRET: As I said, in my speech, it's about a balance between liability and control. And when, in 1999, the Bundesbank gave in, their direct power over monetary policy to the ECB, in which we still have a share of 27 percent, we still believe that the balance between liability and control was working because at the same time, we were getting indirect control over a much larger area.

The same holds true when we now do the same on November 4, when we hand over direct control over 20 German banks to the European Central Bank, which we will work together, because at the ECB, we will be having maybe 1,000 bank supervisors. At the Bundesbank myself, and we have another regulatory body, the BaFin, in Germany. I myself have 1,300 bank supervisors, which shows you that will be a very close cooperation, of course, between the ECB and the national supervisors.

So what we are doing is we are swapping, if that's a good English word, direct control into indirect control over a bigger, integrated part. Which, if there ever would have been a need to see whether there is a pro European stance, this is probably the best proof you can possibly have. So deeper European integration in the financial markets we have been supporting.

I may remind that in 1999, when the European Monetary Union started, the Bundesbank, long before my time, of course, has said that to have a integrated central monetary policy, one will need also a fiscal union, something which was not possible at the time. So we said we will then, nevertheless support the formation of the European Monetary Union. So the Bundesbank plays, I would think, still an important role because we are the largest of the 18 member states central banks. And it's not, so we have an important role in creating and forming in the governing council with regard to monetary policy or in this single supervisory board, where I sit with regard to bank regulation, to sort of promote and support European integration in financial markets.

MR. ELLIOTT: And what do you think needs to be done in the banking union to ensure that national level bank supervision appropriately coordinates with that which is being run more directly out of Frankfurt?

MR. DOMBRET: First of all, you know, we have had a crisis starting 2007, 2008 actually in this country.

MR. ELLIOTT: We've heard something about it.

MR. DOMBRET: And I can tell you Germany had its fair share, a very fair share in this crisis itself. So it doesn't really matter where it starts. It depends on how well you are prepared to sort of deal with shocks which come from some part of the financial system. So in terms of bank supervision, not every bank supervision action today is one one would be proud of. That is not only a German phenomenon, it's an American phenomenon, it's across the world.

So we, if we are smart, we try to learn from those. And we try to have better supervision. The first thing we did in Europe is we created the European Systematic Risk board. And you create a motion towards financial stability, you, we actually learned that the sum of the individual risks of the, the microprudential risks, the sum of those microprudential risks is a lot smaller than risk of the system. So we strengthened macroprudential policies, we strengthen financial stability thought, something I was, as you know, responsible for four years, my first four years in office. And we have also strengthened microprudential policies.

But if microprudential policies stop at the border of your country, which has a central monetary policy, there's a limit to what you can do. And you have kind of very different standards across the 18 member states of the Euro area with regard to bank supervision. And that we harmonize that, especially as banks not only operate in one country, but now are operating across border in the European Union is very important, so I think that we will still have a major role in bank supervision.

In Germany, we have roundabout 1,850 banks, of which we hand over 20, but remain whatever, 1,830. Now they don't make up for the biggest portion, of course, of the assets. But they are still important for the stability. And as we all learned, in a system like the German banking system, where a lot of very small banks operate, this sort of network of banks was a stability factor in the crisis. So you have to make sure that the stability factor remains a stability factor and we will also look after that.

MR. ELLIOTT: Okay. Now, as you point out, the Bundesbank will continue to have an important partial and indirect control over these Frankfurt based entities. So, looking as an important stakeholder, how comfortable are you with the asset quality review that's being taking place and the stress tests that are related to that. The results should be announced relatively soon. Are you comfortable with the process?

MR. DOMBRET: We have decided, or actually, myself. I have decided that we will be following a quiet period until the announcement. And I actually started this quiet period by the middle of September and my other colleagues then sort of followed by the beginning of October. So I will not talk about the AQR and the stress test, especially not about individual results before the announcement, which will come towards the end of this month.

But I can tell you that where we are in the process. The asset quality review is done, is completed. The stress tests, which was an effort where, you know, on certain portfolios, banks had to send data, which then sometimes was not fully complete or compatible, which was then had to be refined. All this data is in. And the European Central Bank has resolved I think almost all red flags to those data. And we are halfway through what is called the supervisory dialogue which I think we'll finish by the end of this week. So that's where we are. We are very progressed in this exercise.

MR. ELLIOTT: Well, you can't blame me for trying, Andreas. Two more questions, then I'll give the audience a chance here. I was interested, your argument against or at least your reservations about having the ECB buy asset backed securities. You seem, it seems to revolve around a question of appropriate level of compensation for the credit risk being taken. I suspect your reservations go deeper than that. So my question is if there were an appropriate insurance premium charged by the ECB, appropriately risk based, would you be comfortable with the ECB buying asset backed securities, or do you have other reservations?

MR. DOMBRET: Let me start by saying that the asset backed securities market is a really important market and that I'm not overly happy of the asset back securities market in Europe. So it is a good thing to have a functioning asset backed security market, so this is not an argument do we want a stronger asset backed securities market or not, I would like a stronger ABS market. Having said that, who is profiting from a stronger asset backed securities market, it's the private sector. So it is in the interest, in the foremost interest of the private sector to have a functioning asset backed securities market.

So what regulation can do, regulation should do in order to help promote that, bank regulation I mean, but it's in the first and foremost the private sector who is buying it and who is issuing it, so there is the, the profit margin is with the private sector. And that's where the effort should be. Now if the European Central Bank would by asset backed securities, you mentioned one way forward, and actually my little speech when you leave will be at the exit door and you can actually read line by line what I said about that, because it's kind of important how I worded it. What I think is --

MR. ELLIOTT: I told you, you'd become a good central banker.

MR. DOMBRET: I have become a careful central banker. But what I'm really trying to say is if there are risks in the private sector and a central bank, whether it's the ECB or any other central bank, buys those risks and mutualizes those risks, without being compensated for the risk premium, that could be compensation by governments, it could be compensation by other methods. You know, we have to see what we are doing. We have to see that we take over bank risks onto the balance sheet of a central bank, which means on to the taxpayers. And I think that's worthwhile pointing out.

MR. ELLIOTT: If that issue were appropriately handled, would you be comfortable with the ECB purchasing asset backed securities as part of monetary policy?

Mr. DOMBRET: I don't really want to be speculative on this, having become a central banker. But I can tell you we have to be much more concrete if we discuss that. Which part of the asset backed securities are bought. Are you talking about the, you know, the risk free part of it, are you talking about the first loss piece, are you talking about the mezzanine. You have to be exactly clear about what is being bought before you really answer that question. And that's not a debate I can have in the public on that. But it really depends on, you know, asset backed securities is a, it could also have covered bonds. Anybody who is familiar with Pfandbrief and all that, you know, big parts of Pfandbrief which are the German government, very, very, very secure. Again, you have to be, you have to go into the detail and the devil is in the detail at the end of it.

MR. ELLIOTT: Okay. So it sounds like as long as they're purchasing good solid German bonds, it will be okay. (laughter)

MR. DOMBRET: That's, you know, we have had a covered bond purchase program we actually executed, but we couldn't get much because they are so good that the investors are not selling.

MR. ELLIOTT: Okay. Fair enough.

MR. DOMBRET: You know, easier said than done.

MR. ELLIOTT: Maybe a bit of pricing issue there, Andreas.

MR. DOMBRET: But that's again, what's the right price. After the announcement of the European Central Bank wanting to buy assets backed securities including some of the more riskier asset backed securities of some countries, the price has changed. So what was the market price? So again, you know, pricing issues are also very, very delicate, and not easily answered.

MR. ELLIOTT: Okay. And I'll ask you one last question. And I'll start out with more of a comment than a question. I think most of us would heartily approve of the idea of a capital markets union. It seems very sensible and certainly from a, broadly speaking, from an American perspective, we think it will be helpful for you to have a somewhat more market based economy in terms of finance. So it sounds like a very worthy goal.

Often, at least when I talk with policy makers in Europe, they agree with that goal, but they have an instinctive resistance to much of what would be required for those markets to actually work. And I was just wondering if you had any comments you would like to make about what you think the most important steps might be towards capital markets union?

MR. DOMBRET: For that, I'm going to be a little bit repetitive, because I think that the tax treatment actually is one of the most important steps to take if you have such a debt bias in the tax treatment and then how will equity really be promoted in a proper way. I think that the integration is not only of financial markets, for example, the credit market, but it's also a, it goes much beyond, again, you can read this in my little transcript, much beyond only credit markets or private equity markets.

It goes into central counterparties. It goes into stock exchanges, we have to be integrated. So the entire infrastructure of the financial markets is also interconnected. This is not done just overnight. But you have to start and taxation, I think, would be the biggest issue, because at the end of the day, tax treatments have a very big impact on thinking and investing.

MR. ELLIOTT: Well, the good news is it sounds like we have a whole topic for your next speech at Brookings because there are obviously many aspects there. So, yeah, let me take questions from the audience.

Just a few simple ground rules. They should actually be questions. Try to keep them to one at a time, because we have a lot of people with their hands up, so I'd like to give everyone a chance before we go back to repeats. And I think those are the entirety of the ground rules. Sir?

MR. WIJNHOLDS: I'm Onno Wijnholds.

MR. ELLIOTT: Oh, no, I'm sorry. I knew there was another one, which you're doing appropriately. Please do identify yourself.

MR. WIJNHOLDS: Yeah. I'm Onno Winjnholds. I am a former central banker. I worked at the IMF as an ED and I was, the last part of my career, was to be the ECB representative in Washington. I'm an ex-central banker, as I said, so I feel a little more free to go a little deeper into let's say, some of the issues.

I was struck by what you said about the asset backed program and you have quite strong doubts, it seems, about that. Can I interpret that you would feel that you are a little isolated on this issue, the Bundesbank, and would you agree that your position is quite strongly that monetary policy has done what it could and it's up to others now to move, if we want to stimulate demand a little bit in Europe. Fiscal, for instance, I'm not sure what you would think about Germany for instance, stimulating through a few measures this economy, which seems to be weaker in Germany now than it was recently.

And a second short question is the Euro is falling and, uh, against the dollar. Not really dramatically but substantially. How do you feel about that? I know the ECB does not have an exchange rate target, but still politicians have been talking about the sum of (inaudible) saying this is a good thing because it makes some of the countries in Europe, the weaker ones more competitive and actually it could help push inflation up a little bit, something that a lot of people would like to see. But there's the other issue saying well, we already have imbalance of payment surplus so what would you be, what is your position on that? Thank you.

MR. DOMBRET: Thank you for those questions. And I'll answer them combined because they have a line which connects them. First of all, I am staying away from questions about foreign exchange rate, interest rates and since some weeks now, also on inflation rates. But I would like to answer them in a fundamental way.

If we have a weaker dollar, a weaker Euro, rather, vis-a-vis the dollar, you talked about our competitiveness. Clearly, it increased competitiveness. I don't need to remind you that all 18 member states in the Euro area have the same currency. So if some countries gain competitiveness by a weaker Euro, there must be something else than a different currency, but there must be a competitive disadvantage in those countries.

And I would recommend thinking about structural measures to overcome competitiveness, than really trying to think that you can increase competitiveness by an exchange rate, which as you exactly correctly said, it is not a goal of the Europeans.

With regard to the asset backed securities and whether we are isolated or not. As you know yourself very well, we never comment on, on voting during governing council. I was there actually. And I'm not a member of the governing council, so I'm not the one to say that. But I can tell you that it's worthwhile reading the interview of my president in today's Wall Street Journal, who actually talked about this, so who hasn't done so, I recommend reading this. And I actually very much go along your theme that monetary policy in the Euro area has done so much up to now. And, you know, I, it could take me half an hour to say what we've done. I'm not going to mention all those measures, but only that we have very low interest rate, that we have full allotment, that we have, you know, we take, we have changed the rules on collateral. We have lowered those requirements, etc. etc. etc. We have liquidity in the market. We have LTROs and TLTROs. We are running out of abbreviations. And so what I'm trying to say is we have done so much now that it needs to be complimented by sound structural measures of our fiscal policy.

And especially in a monetary union like the European, which I tried to explain at the beginning of my little speech, where I said there is only one example in the world of one central monetary policy and decentralized fiscal policies. Especially in a monetary union like this, it is important that, that monetary policy does not become a hostage of fiscal policy. It has to be two different things.

And that's why I think the initiatives of the Australian presidency of the G20 and we will be meeting, the deputy meeting tomorrow and on Friday, the finance ministers and governors will meet to discuss the Australian president's G20's initiatives on growth, especially structured growth is exactly the right initiative to have.

MS. GARCIA: Gillian Garcia, formerly with the IMF. I have a question about the banking union, particularly the resolution part and most particularly about something you didn't mention, deposit insurance. How far has that system been unified and do you think it needs further unification?

MR. DOMBRET: Thank you also for this question. Now, of course, the banking union consists of the supervision as well as the resolution. We have now agreement of both. One is coming very, very soon, in less than a month. And the other one is coming in all of the Euro area by 2006. We don't have any integration on deposit insurance. It's a very, very national system. What we have agreed upon is to which extent deposits are secured up to 100,000 Euros and they are also exempt of the bail-in rules, as you know. But we haven't gone any further. This is then, if we were to do that, we would of course then have a mutualization of debt.

Basically, let me tell you my strong belief about the Euro area. There are two ways forward, yeah. And as I mentioned, you go into a fiscal union or you stay in the present system. As I tried to argue that whether you like to go to a fiscal union or not, it doesn't seem to be something which seems to be around the corner. I make a living of traveling to the capitals of these 18 Euro area countries and nobody, nobody is saying we would like to give up sovereignty in fiscal policy.

So, we have to stick with the present system. In the fiscal union part, a euro (inaudible), the mutualization of debt in deposit insurance would be a logical step. But if you don't go there, and you stay in the national fiscal systems, it is not. So you have to be consistent. You have to make a choice. If you say I would like, I don't want the fiscal union, but I want the elements of a fiscal union without doing it, you are becoming very, very inconsistent.

So this mutualization of the deposit insurance is a far way out, but will come automatically the more integration we go. That's why we have monetary union, we are doing banking union. I am suggesting capital markets union. I'm not the only one. Even the president of the Euro Commission is doing it. And then we're going to go towards more integration. So it's not something which is around the corner at all.

MR. ELLIOTT: Since you brought up consistency, isn't the exact issue you described already present in the agreed upon changes on resolution? There's a mutualization to some extent--

MR. DOMBRET: Yes.

MR. ELLIOTT: -- of the cost of resolution. If the fiscal union argument applies there.

MR. DOMBRET: Yes. It is. You are right, Doug. But on the other hand, you cannot have effective bank supervision if the supervisor doesn't have a credible threat so to say, against the bank, I will resolve you in the case officer incident. So the resolution has to go hand in hand with the supervision. The deposit insurance doesn't have to hand in hand. That is not as necessary as resolution and supervision.

MR. ELLIOTT: I disagree with you there. But, I'll leave you with that, sir.

MR. HERRIOT: Judd Herriot, documentary filmmaker. There is a fear recently voiced by Christine Lagarde at the IMF that the Eurozone will slip once again into recession. I'd like to get your commentary on the crisis, not a crisis, but the dispute between those who advocate fiscal stability, mainly the Germans and those who are pushing now for fiscal relaxation, relaxing the targets, to permit more demand driven fiscal policies. I'd like to get your comment on that. But more important, how would this complicate your efforts towards monetary union?

MR. DOMBRET: Yeah. I promise to watch your movies because if you ask such interesting questions, these movies must be very interesting. But coming back to your question. It is also almost a philosophical question. A philosophical question in an economic way, and it's very hard to say what is right and what is wrong. But my belief is, strong belief is that the problem we are having in the Euro area is not our debt to GDP ratio is worse than the United States, or especially Japan, yeah, that our ratios are that much worse. But that we are living in a confidence crisis in the Euro area. It's a real -– it's a crisis in the confidence of the framework, of the institutional framework to hold.

And the confidence crisis stems from the fact that we had too much debt. And it was unclear as who is going to pay back the debt. If you answer a confidence crisis by even enlarging the debt you are holding, I have my sincere doubts that you are bringing down, or bringing up confidence and bringing down doubts. So it is a mixture of two things which I believe in.

It's a mixture of a, reducing the debt load. As you say, fiscal stability and at the same time, introducing structural reforms in order to promote your competitiveness. So you cannot do the one without the other. We should not be doing one without the other. The German position is not one, let's save no matter what, but saving in order to bring back confidence to the Euro area and at the same time, introducing structural reforms, which Germany did, as you know, agenda 2010 of the former chancellor, in order to make Germany more competitive.

My last comment would be now if Christine or others asked for Germany to go ahead and be the one to relax first because it has a better position, don't forget that Germany is the stability anchor, being the strongest economy in the Euro area. If we weaken the stability anchor for the Euro area, I have my questions whether that's the right thing to do for the Euro area, because a strong Germany, a fiscally sound Germany helps of course, the rest of the Euro area.

MR. ELLIOTT: Alex, yeah.

MR. PRIVITERA: Thanks, Doug. Alexx Privitera with AICGS. My question goes back to the ABS purchases and the figures surrounding the potential universe of eligible assets. Vitor Constancio, the vice-president of the ECB just came out today with a figure between covered bonds and ABS. He named the possible price tag of one trillion Euros. How substantially would that universe shrink in the absence of any form of government or public guarantee for those ABS purchases, given your point, the point that you raised about the credit risks that the ECB is assuming? Thank you.

MR. DOMBRET: Yeah, thanks for the question, any question from the AICGS are always very important. But this one I would like to dodge, because I don't want to have (laughter) I don't want to have a discussion. I don't want to have a discussion about the amounts. You can possibly purchase in any indirect effect that has. The point I want to make is a fundamental point.

The fundamental point of not putting credit risks onto a central bank. That's the point I want to make. And I don't want to speculate how much we have and how much we don't have. Then, I would have to make assumptions on what exactly are we buying, which charges are we buying, which maturities are we buying. That would be cycling to them market, which exactly is not my job and I don't want to do.

MR. ELLIOTT: The fellow in the snazzy sweater back there. Yeah.

QUESTIONER: Thank you for the comment about the sweater. Chris (inaudible) from Manufacturers Alliance for Productivity and Innovation. If I got you right, you seem to be making a distinction between the health or the wellbeing of the balance sheet of the ECB and that of the taxpayers. Isn't that one in the same thing? That the taxpayers are the principals and the ECB is the agent and the ECB acts on behalf of the principal to produce some kind of a monetary policy that is good for everyone. And if that's the case, then what we have in Europe is a problem of these cohorts of taxpayers which are grouped along national border, unlike in the United States where the districts roughly correspond to a given population and geographical area. And these cohorts within Europe then have such diverse preferences that a distinct and useful monetary policy is held hostage by this. So how would you reform this? If I'm right, is there room for reform along the lines where even without the political and fiscal union, you would have a much more effective policy reflecting the interests and the preferences of the principal, which are the taxpayers, and the agent, which is the ECB?

MR. BOMBRET: Yeah. Thanks for that question. Now, I have a very simple belief which I can quote (inaudible) among others on this. And if I translate it into English, it would mean the ones who have the benefit should carry the costs. So, the banks have the benefit of, let's say their credit portfolios and they should take the costs. We go into an imbalanced system that if we, the banks, as we had in the crisis, remember, where banks, if they made a lot of money, paid themselves and their investors a lot of money. But if things went wrong, they went to the taxpayer. So it's like throwing up a coin. If you have one side, you make a lot of money, you take it, if you lose a lot of money, the taxpayer pays.

That is not a very healthy equation I would recommend. So, and that's the same thing here with credit risks. If we take a lot of credit risks without anybody compensating you for the credit risks, you're putting the credit risks from the banks. I have nothing against banks. But put the credit risks from banks onto the ECB, i.e., onto the taxpayer. I don't think that's what we should be doing. That's not the central banking I'm thinking about. So what I was trying to say when, and you can read it, if you care to, when you leave, I said it's about the compensation for the credit risks (inaudible). So, and the taxpayer as you said, is very national. They have very national interests, exactly as you say, and this is again, this imbalance between the central monetary policy and the very decentral fiscal policies which are then of course as (inaudible) and very decentralized national taxpayers.

So, we have exactly what you, what we described. So what we have to do is I have no problem, as I said by the balance of liability and control. If you have more control, you can have higher liability. If you have the profit, you should have the cost. It is about the balance, the equilibrium amongst these things, which have to be in place.

MR. ELLIOTT: Further questions, the lady over there.

MS. XAFA: I'm Miranda Xafa, senior scholar at CG and formerly with the IMF. You mentioned the SMP program that was put together by the ECB early on in the crisis in order to keep borrowing costs down. A couple of years later, when the Greek debt restructuring was agreed, the ECB and the National Central Banks of the Eurozone excluded themselves from the, the debt restructuring and the haircut. But third country banks, like the People's Bank of China were subjected to the same haircut. What was the rationale for the seniority enjoyed by the ECB and the Euro system banks compared to, let's say, the People's Bank of China that contributed just as much to firefighting by buying and holding Greek government bonds. Thank you.

MR. DOMBRET: Thank you. Now, I don't want to comment on our colleagues from the People's Bank of China, but I can tell you what the rationale was for the Euro system, for the ECB and ourselves in the national center banks. Under European law, and for all the good reasons, monetary financing is forbidden for central banks. And that's the reason why we couldn't participate in this because it would be a clear case of monetary financing. How the People's Bank of China is wrapped into that, I really don't know.

MR. BERRY: Brian Berry, Washington correspondent, Euro politics. Just, if I could go back to what you said about President Juncker's proposal. Could you just maybe clarify, are you referring to the 300 billion Euro package of investment that President Juncker said he wants and more public money?

MR. DOMBRET: Yes.

MR. BERRY: And just further explain why you think that it's not a good idea. I was not even aware that he had come out and cited the ECM as the source for that public money.

MR. DOMBRET: First of all, the first answer is yes. I was referring to that suggestion. And the idea behind this is the following, as I've tried to explain. The objective of the European Stabilization Mechanism is to have a mechanism which you, with money, you can advance in order to protect countries against speculators, against speculating against a country.

And as you know, the ESM invested in, if that's the right English word, invested, you know, they provided funds in Ireland, in of course, then later in Greece in a second step. It was the EFSF at first. And then of course in Portugal and in Greece.

MR. BERRY: Spain?

MR. DOMBRET: Spain only for the Spanish banking system. Not for Spain, but for the Spanish bank. And some of this money has been paid back. As you know, Portugal paid back, Ireland paid back most of it, and the Spanish banking system also paid back.

So this is an amount of money which has a clear purpose and a clear objective. If you, I don't know the right English words. If you now change the rules and say no, now it's for a different purpose, you make potential speculation against countries, of course, easier. This is not the idea under which these funds was put together and it should stay together if you want to do infrastructure financing. You are very much welcome to come up with funds for infrastructure financing makes a whole lot of sense.

By the way, we're living in times with very high liquidity. So funds, there's no shortage of funds. It depends on the projects and so at the end of the day, I think that the ESM is a decision which should stand, and if we now sort of change the rules, and I excuse my English. If that's maybe bad English, I excuse myself, but you should just keep the objective clear. And if you keep it clear, you have a lot less incentive as I wrote, or said in my speech, a lot less incentive to speculate against the country, which is exactly something we want.

You can now argue we don't need the ESM fund anymore. If that would be the argument, you could of course, dissolve it and have another fund. But then you would have another decision. But as long as this decision stands, you should stick with what the decision was at the beginning.

MR. NOVELLI: Thank you. Hi. I just, listening to what you said before, you said that—

MR. ELLIOTT: Identify yourself.

MR. NOVELLI: Sorry. I'm Victor Novelli, an Italian law student. And listening to what you said before, you said.

MR. DOMBRET: European law or American law, from Italy?

MR. NOVELLI: Italian law. Italian law, but I'm here on exchange. Listening to what you said before, you said you are partly against the ESM and, because you said it is inefficient and the Euro bonds. It looks to me that your idea and German idea in general, is a bit of distrust in what the countries of the European Union would do if they were given some, well, you know, some more freedom. So, and this is at the basis also of the fiscal stability that you are actually endeavoring as German in the European Union.

Is this like, does this may lead to consistent oppositions to this policy? I'm thinking about France who recently said that they're not going to respect the parameter of three percent of their GDP in growth. So is there, and Italy prime minister who praised this decision. So is there a risks that this distrust in a certain way towards the, to some of the European countries and the financial stability that you are actually endeavoring might leave to an outburst of these, well oppositions to your policies? Shouldn't it be more relaxed again? Thank you.

MR. DOMBRET: Thank you for the question. First of all, you are overestimating my powers, because it's not my policy, it's a stability and growth pact. It's a mutually agreed upon contract, so to say, that everybody said we're going to stay within these rules. Now, again, it's important to understand the European Monetary Union. If you have a central monetary policy and fiscal policy can do whatever it wants, then there's a disconnect between monetary policy and fiscal policy. I think everybody agrees upon that. Now that's why you need the stability and growth pact to keep fiscal policies in check. Every fiscal policy is national, but they have to sort of work together in the same direction. And that's why we have these rules. So it's not my policy. It's not the German policy. It's the stability and growth pact.

And, you may be astonished, but if you were to ask the Bundesbank, we will tell you we would be very happy if everybody would live by the stability and growth pact. We don't want more, or you know, it is just what everybody agreed upon, which makes a monetary union workable. I wonder how you can have a monetary union if you don't have a connect between the central monetary policy and the national fiscal policies.

By the way, everybody in the governing council actually agrees on that. That is not a disagreement whatsoever. So it depends on how you make this monetary union work. And if we don't get it work, we come back to this gentleman's question on the first row, how can you then, you know, keep the confidence in the system if everybody does what he or she wants while you have a centralized monetary policy. You need coordinated approach if you don't have a fiscal union, which we all agreed is not around the corner very, very soon, at all.

So you have to have, so it's not our policies. It is a commonly agreed rule about, which the Euro Commission is watching, and the Euro Commission has to make a statement. Again, it's not a German statement, it's the Euro Commission saying you can have a little bit more time in order to fulfill this or not. This is not our position. And so it's, at the end of the day, we cannot work a monetary union if we don't go into the same direction and stay within certain barriers. If you cannot devalue the currency anymore, you need to go to the other areas which you have. Otherwise, a central monetary policy has that big limits and challenges that it's very, very difficult to run a monetary union.

MR. ELLIOTT: The fellow just in front of the last questioner. Sir, this way.

MR. SCARLIS: I'm Basil Scarlis. I used to deal with economics issues at the State Department a year years ago. My question relates to some of your earlier comments and I just wanted a clarification. And it's related also to Mario Monti's piece in the Financial Times today. The essence of it was that yes, there should be structural reforms on the periphery, but there should also be a privileged place for public investment in infrastructure. Do you think that this could be worked out somehow in the European Union that is. It wouldn't threaten stability if the focus was public investment in infrastructure and that asset backed securities could be used in that matter?

MR. DOMBRET: Yeah, thank you. I didn't read President Monti's piece in the FT today. I'll sure read it because that sounds interesting. Now, my personal experience with infrastructure measures are twofold. The first impression is they're very important, especially in the lesser developed countries, they're hugely important and make a big difference.

My second impression is not every single infrastructure project is efficient and not every single infrastructure project is necessary. And what really counts is to have infrastructure projects which adds to the welfare of the country. And I know infrastructure projects in Germany which didn't necessarily do that. I know of infrastructure projects in other very developed countries. So to say infrastructure is good or bad, of course it's good as long as it's efficient.

And how much public money can be used for that, that is up to fiscal policy and I, as somebody who is responsible for parts of monetary policy shouldn't comment on it. But I like the idea. (laughter).

MR. ELLIOTT: Fair enough. Yeah.

MR. TOMA: Jason Toma from here at Brookings. Thank you for your comments. My question is, you know, in Western democracies, the type of reforms that happen, the ones that you're advocating, typically don't happen until after a major destabilizing crisis because that's just the pace of how we do things. So we've had the crisis, yet you don't sound very optimistic about the way forward with some of the measures that you're suggesting. So I guess my question is if not now, when, what's the forcing function. I know you can't predict the future and I know you'll probably say you won't thank me for this question. But you know, if not now, when and as in the near term of the three areas that you suggested, which do you see as the most promising in terms of getting traction and for confidence building measures within the monetary union. Thank you.

MR. DOMBRET: Yeah, but that was a good question and so I thank you for that. I have to say that all three projects are kind of very realistic. And you know, look at the monetary union project, we're in the middle of it. It started in 1999. Look at the banking union project, starting on November 4th and resolution starting on the 1st of January, 2016. The capital markets project is one, union project, is one, which is in the speech at the core of the president of the Euro Commission. Well that's a pretty prominent, a pretty prominent place to be. So I think all three are very realistic and worth pursuing. As I said, you do it in a balanced way. You don't mix diverging goals. But to do it, I think we can have a lot of positive effects from all of this.

MR. ELLIOTT: I'm assuming he may have been referring more to the fiscal union part, which you've described as for--

MR. DOMBRET: Yeah. Okay. Well, now with regard to the fiscal union, this is not dodging your question very much. The issue of a fiscal union is an issue of policy makers to take, policy makers from up -– political, political leaders to take. Now, monetary policy, policy makers can have an opinion. But this is a political decision. You have, you as a political leader, you have to present to your public and to your voters and you have to gain, how should I say, a majority for. This goes far beyond a monetary policy mandate I have.

That is a structural, political project. And that is not my mandate. I have a narrow monetary policy mandate. So from my point of view, whether you go to a fiscal union or whether you stay in the present concept, both economically can work, and we would say what would it need to be successful in option one or option two. But which option to take is a very clear responsibility and task for political leaders, not for monetary policy, policy makers.

MS. MARSHEF: Hi. I'm Liz Marshef. I'm from Georgetown Law School. My question is where given these base of reforms forming the monetary union and moving to banking union and then to capital markets union without having even a minimum harmonization on the fiscal side, you think would it be, these structures would be vibrant enough to support another crisis of the same magnitude that we had recently?

MR. DOMBRET: First of all, I don't see a crisis of the same magnitude around the corner, which is good news, which of course, doesn't mean that we will not have another crisis. And as we all know, we will have crisis and the, what goes down must go up and goes up must go down to some extent. The real question is will there by a systemic crisis and how much are we prepared in order to cushion ourselves to get, how many stabilizer have we built against going into such a crisis.

I think that we do have, if we leave the stability and growth pact, as the Italian colleague of yours, law student colleague of yours asked, if we leave the stability and growth pact, we are pretty fine, we are pretty okay. The dangers come when investors in markets look at us deviating from what we have decided. And then there's a question of will this be, go back into play or will this stay a part and how are the mechanisms to react to deviations. That is the real issue of where the confidence crisis comes from. So basically, I think as long as we are staying within the parameters of the stability and growth pact, economically this is something that can work without needing to go to the fiscal union. Without me expressing any judgment of whether the fiscal union or the present state of play is better or worse, as long as it's consistent and as long as it's complied with and implemented, both can work.

MR. ELLIOTT: Okay. So you've been very, very generous about taking questions. Given what you've been hearing from people and your own thoughts, is there anything else you'd like to add before we end? Any points you'd like to expand on?

MR. DOMBRET: You know, I try to put myself into the shoes of the American audience when coming to Washington, and I must say it must be difficult to understand the European debt crisis and, you know, I mentioned in passing that this global financial crisis started in the United States. But on the other hand, I could mention that the economy, which is growing, and which has repaired its banking system quickest, is also the United States of America. So we have a lot of work to do, but let me come back to what I said at the beginning of my speech.

I think we are facing this under and over statement. You know, I think you over estimated, you over estimated, or how should I say, you thought there would be not enough political will in 18 member countries, I think it was 17 at the time and now there are 18, in those member countries to go through all the parliaments, to go through all these sessions, and you thought euro will, there will be a breakup scenario. And you got that wrong.

And I thought the stability and growth pact, because people will of course, that's a very German way of looking at things, people of course will stick to rules. I thought the stability and growth pact is much, much, much safer than it was. So I think everybody got it partially wrong. And, and so what we have to do as this crisis not over, but we are a lot less in a, in a dark sworn type of situation, we have to work hard in order to stabilize the situation. We are doing that. The, the black swan situations are a lot less likely now, and now we have to move forward integrating deeper because that's the right thing to do, but we have to do it in a realistic and in a balanced way.

MR. ELLIOTT: Thank you very much, Andreas.

MR. DOMBRET: Thank you.

MR. ELLIOTT: We very much appreciate you coming here.

(Applause)

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