C. Fred Bergsten: Let me welcome all of you on this rainy morning to the Peterson Institute for International Economics. Our new President, Adam Posen, is up testifying to the Joint Economic Committee this morning on the remit of the Federal Reserve—so an important topic—and he asked me to, for a moment, take my old place as chairman of these sessions here at the Institute.

I could not be more pleased to do so to introduce our speaker today, Anders Borg, who is both an old friend and close associate, and literally, literally probably the world’s top finance minister. He has been named such in Europe. He’s the dean now of serving finance ministers in the entire OECD [Organization for Economic Cooperation and Development] and that’s not because he’s an old guy, as you can see from his countenance.

He’s been a minister of finance in Sweden since 2006. That does mark a rather long tenure for such positions. He’s been the chief architect of the Swedish government’s economic policy, which of course has propelled his country into the most successful response to the crisis and successful navigating of the crisis certainly in Europe and one of the most in the world. So it’s a great pleasure to welcome Anders back to our podium here for the third time.

Prior to becoming finance minister, he was chief economist of the moderate party. He was an adviser on monetary policy to the Riksbank. He headed up the Economic Analysis department at SEB, Skandinaviska Enskilda Banken, and was a political adviser to Prime Minister Carl Bildt back in the early 1990s when Sweden overcame its own economic crisis, dramatically reformed its economic policies, and put itself on the course to where it is now so successfully navigated, responded to, and overcome the crisis of the last few years.

So Anders, we’re delighted you’re here in town for the IMF [International Monetary Fund] meetings. It’s a very great pleasure and privilege to welcome you back to the podium here at the Peterson Institute and we look forward to partaking of your wisdom once again. Great to see you.

Anders Borg: Thank you very much. I will give some views on the current position of Europe and basically how I view that we should use fiscal policy in this kind of situation and going forward. There will be three basic messages. One is that the crisis is not over. I think we still have some clearly political risks in Italy and Spain that can come back and create some further turmoil in 13 and maybe it will take some time even longer than that to sort things out.

The second message is that I think we should be using fiscal policy as a tool of stabilization. There are obviously some limits to what can be done with fiscal policy but basically I think we should try to organize our economic policy setting so that the fiscal policy can play an active role to stabilize demand and growth.

I will also argue that the depth level is in Europe quite a problematic issue and some of these fundamental issues that are different between the US and Europe is that the depth of the structure problems are much, much worse than they are in the US, particularly on the
labor market, but also when it comes to long-term gross numbers. So in Europe, part of the solution must be that we are changing the functioning of our economies and doing long-term structural reforms.

If we look at the short-term economic prospect, I think it’s quite clear that we are not out of the woods yet. I think we have some quite fundamental problems in some of our European economies that has not been resolved. If we look for example, at Italy, they have a unit labor cost situation which brings them some 30, 40 percent above Germany in terms of cost level. The difference between Italy, Greece, and Spain is that in Italy they are still moving in the wrong direction.

In Greece, in Spain, we’ve seen quite a dramatic increase of productivity and a very low cost pressure, which means that they have regained quite a lot of their competitive situation. That is not the case so far in Italy. There has been very ambitious reforms from the Monti government that is moving in the right direction but we can actually see very little effect of that in data so far.

The problem with that is it’s quite clear that Italy needs to continue to reform maybe for another five to 10 years. Given the current political situation after the election, it is very hard to see how that could be resolved. So therefore, I think one has to be very optimistic if one doesn’t think that the problems in Italy will come back to the top of the agenda.

Also when we are looking at Spain, I think we have a quite problematic situation, particularly in the banking sector. There is a drop now in bank lending to households and firm of almost 15 percent if the numbers of the World Economic Outlook is correct. It actually looks like a severe contraction only in the last three to six months. It’s gone from minus 10 percent to minus 15 percent since October. Those kind of numbers are indicating that there is still quite a heavy monetary contraction. I think we still are in a situation where house prices have not stabilized.

So to my mind, it’s quite clear that not only Greece, but also Italy and Spain, might come back to the agenda and I think we should be clear that the next round of Troika negotiations will come back to the agenda in May and I think the best guess is that we’re still seeing some slippage when it comes to expenditure control and revenues in Greece.

So from a US perspective, it’s quite clear that the economy is starting to come out of the crisis and start to regain some more normal pace of a recovery. From a European perspective, I think one should be cautious. Both the Fund and ourselves and the commission are actually forecasting negative growth this year. We had negative growth last year and the growth forecast for next year of the euro zone is close to 1 percentage point.

So the weakness of the recovery in Europe I think will remain and I’m not certain that the market is actually appreciating this fully. We are now seeing the bond rates going continuously down on the back of the Bank of Japan’s very I think, reasonable action but the problem is that there could be quite some setbacks when it comes to political risk to my mind.

It’s important to realize that this is a structural crisis. If we look at GDP growth, it has not been strong in the United States. It’s been better in Sweden, but I think nobody should be satisfied with the growth rate of some percentage point. The problem is that the euro area has actually been worse and if take a longer term perspective, a 10-year perspective or a 20-year perspective, the growth numbers have been quite poor. There’s been several countries where the total factor productivity growth has been below 1 percent, which I think is a very dismal result.

Also I’m going to look at unemployment and employment rates, labor force participation, long-term unemployment, it is quite clear that Europe is in a much worse situation than the US in terms of the labor market.
Obviously, that is also what we’re seeing in the employment rate here. Even the US with its close to 67 to 68 percent is on the lower side I would argue, but the potential for the euro area to increase employment rate is quite substantial. I think it would be very reasonable to see the levels up well above 60 to 70 percent and they are now currently rounding at 64 percent. This is indicating together with the unemployment rate, that there is a fundamental structure problem in the European labor market.

In combination with that, we have now quite high depth levels in all of our big economies and that’s a part of the picture.

Let me say a few words of how one could assess the situation and the fiscal storms for the years to come. I actually would argue the case that Europe is at a quite reasonable balance as it is. If we look at the countries with a relatively strong position, the UK and France, what they have done is actually to postpone not the measures, but they have let the automatic stabilizers work. So for example, I think the UK is going now down to 5 percent deficit from a top level of some 10 percent at the deepest part of the crisis.

So there has not been a—the media picture is that there’s been a very dramatic fiscal austerity program in France or the UK. I would argue that they’ve done quite a balanced [inaudible 00:10:16]. If you look at the UK data, it’s very similar to what we are seeing in the US. I think the numbers are almost Siamese twins between the UK and the US.

In this situation with weaker growth, I think it’s very reasonable that they take some more time to achieve the 3 percent target of the deficit. They can actually see tax revenues go down a little bit, and expenditures increase a little bit, and take some more time, but I don’t think they actually have room for doing active fiscal measures.

Then we have the countries with relatively strong position. That would mean Germany, Finland, Austria, Sweden, Denmark, maybe also Norway and Switzerland. If you take the German position, I will compare Germany and Sweden, I think actually the German government has struck the right balance when it comes to dealing with their issues. They are now at 80 percent depth level. Maybe one could argue that they could take on 10 to 15 percent depth more without creating any really long-term problems with the anchor of the euro area.

Well, if we are thinking of increasingly the German depth, one should ask oneself what should that be used for? Is it better to use that as a buffer for other euro countries that might run into problems? If there is a non-negligible risk that another country would go into a program, it is quite clear that you need to have a solid back stop for that. If in this crisis, or in the next crisis would happen, I would argue that it’s more rational that the fiscal space in Germany is used for creating a back stop for the rest of the euro area.

Particularly, one should remember that we are now in Europe building a banking union. A banking union means that ECB [European Central Bank] will take over supervision, but it also means that we will need to build some kind of common deposit insurance system and also some kind of resolution authority.

Well, that also means that there has to be a solid back stop for the banking union. So if there are some fiscal space in Germany, I think that should be used for creating stability and anchoring a banking union with a German back stop. And if we are looking at the German situation, let’s remember that before the crisis, Germany had 10 percent unemployment. It today has 5 percent unemployment. Unemployment in Germany has been halved during the crisis. Labor force participation has actually increased 3 to 4 percent and employment has also increased and youth unemployment are today well below 10 percent, almost 5 to 6 percent lower than the equivalent numbers for the US.
So it's quite clear that the number of available resources in Germany are not as they are in
for example, of the US or the rest of Europe. So I would argue that maybe in Germany, you
could do measures where you are maybe cutting taxes in the short term, but then you need
to anchor that in a path for expenditures that is on the downward side, otherwise I don't
think there is much fiscal space in Germany in the space that should be used for the euro
area and for the banking union, not for short-term stimulus measures.

In my own country, I would argue that we actually have fiscal room to maneuver and
I would argue that case to give a kind of a contrast to Germany. Our depth level is 40
percent. We have had structural surpluses all along during the crisis. We have actually an 8
percent unemployment, which will not go down to 6 percent until maybe 16 or 17, so it's
quite clear that our output cap is much bigger than the German output cap.

We have current account surplus of some 7 to 8 percent currently and we basically have a
credibility problem in the reverse. We are seeing the krona strengthening every time there is
turmoil in the world market, which is not what you actually would like to see.

So for us, it's quite clear that you could see arguments for doing further fiscal stimulus in
14 and maybe also 15, but by saying that, I also think that it would be very, very difficult to
argue that case for Germany.

In the Swedish case, I do believe that what we will be doing is long-term growth measures.
We don't believe in temporary or targeted fiscal stimulus, but rather continuing dealing
with our own structural problems and cutting back taxes and increasing spending on
education in the long term, rather than just doing short-term progress.

So there is a picture in the media that Europe is only about austerity. I would argue that
austerity is necessary for some of the countries that is in complete lack of market credibility,
but even for Spain and Greece, the decisions taken in the ECOFIN has said they actually
accepted that the implementation of these measures are prolonged. Spain for example is
going for 10 percent deficit last year to 7 percent deficit next year.

Obviously, that is a deficit reduction, but it's not a dramatic deficit reduction and I would
argue that the balance is there.

So the main issue for the euro area is not about fiscal policy in the short-term but rather
to create a banking structure, a banking union that would alleviate the pressure on the
credit market.

So what can we say that we have learned in the crisis about fiscal policy? Well, I think the
major lesson is that fiscal policy is a tool that should be used. When I was working at the
Riksbank, I think the common wisdom among central bankers is that stabilization policy
was for monetary policy. You would use an inflation target then you would use your policy
rate to balance output and unemployment.

Today, I would argue that almost everybody believes that fiscal policy has a role to play and
there are some very important arguments for that, particularly if you have a debt deflation
situation or a zero [inaudible 00:16:32] problem where the efficiency of monetary policy
is extremely weak. If you have a large construction sector or a housing sector that's gone
from a boom to a bust, it is fairly likely that a country would very much look like the
US, Ireland, Spain, for a quite prolonged time period. And in such a situation, it's very
reasonable to do what you can from fiscal policy to stabilize the situation.

So if we realize that we need to use fiscal policy, I also think we've realized that depth is
much more important than we thought. Olivier Blanchard, who should not be considered
as a fiscal conservative, argued at the conference at the IMF now, that previously we thought that the 60 percent depth level was safe for countries. I think Ireland, Latvia, Iceland, Spain, and a lot of the other countries have shown to us that 60 percent is not safe.

At 60 percent, you are only a banking crisis and a long downturn away from coming very close to unsustainable depth levels. The problem is that we have actually seen financial crises almost every third or every fourth year over the last almost 20 years. If you go back and start with the Mexico crisis, that was only two or three years before we had the Scandinavian crisis and banking crisis. After that, we have also the United Kingdom going into an ERM [Exchange Rate Mechanism] crisis and then obviously, we saw another round in Mexico in 1995 and then the Asian crisis came in 1997. We had LTCM [Long-Term Capital Management] and Russia in 1998 and we had the dot com bubble in 2000–01 and then we had the Great Recession that is now living through.

So I think one should realize that we are living in a very turbulent and problematic world. So we have to take the debt level serious. If you believe that fiscal policy has a role to play, it is extremely necessary to pay down debt and get back to a stable situation.

So how can this difficult conflict between depth and the need for use of fiscal policy be squared? I would argue that it has a lot to do with institutions. We need to change the institutions around fiscal policy to create a valid process, a policy testing process that is much more long-term stable, but also adjusted to being able to deal with the necessary issues.

Just to give you the kind of sense, because most people don’t realize how long the lags are in fiscal policy. When we are deciding how to use our own fiscal space, let me take the example this year when we have cut corporate taxes down from 26 to 22 percent, that had to do because we had a lot of problems of interest rate reductions being used for tax evasion, people moving profits out of Sweden into Cyprus or Ireland or other countries. So big loans in Sweden with deductions and the profits taken out in low tax zones.

So when we have to deal with that, the legal complexity of the issue, we have to start in—we do budget in September—two weeks after we’ve done the budget, I gather my chief policy advisers and then we start on the next budget because that’s the time lag. If you want to be able in April to have a proposal that can go to our legal counsel, which is a requirement before it goes to Parliament, you have to do all the preparatory work so you could send it out for being assessed in early February, March.

So basically, if you’re going to do a structural reform, at least you need a year ahead to plan for this process and a lot of things can change over a year. I mean, you definitely can see fiscal deficit going up 1, 2, or even 3 percent in a year because the forecasts are so uncertain. So you need to have a long process where it can be flexible and particularly if you believe that the key, at least for Europe, is to do structural or long-term measures to improve growth and the labor market and that I think puts a lot of demand on how we are organized in fiscal policy.

You also, I think, need to see a fundamental change of the fiscal institutions so that you’re creating room to maneuver. In Sweden, we have a situation that if we don’t do anything, there will be a fiscal contraction of 0.5, 0.6, 0.7 percent per year and that has to do with the fact that we’ve set a large part of our subsidies for the welfare services in nominal terms. So if there are no political decisions, automatically in real terms there is a decrease of spending.

We have also introduced a system where basically all the government agencies have to—when they get compensated for wages and prices, there is a deduction from the average private domestic sector productivity. So also in the public sector, there is a demand for
productivity increases and this means that if we want to do measures to stimulate the economy, we can do that, and it’s still credible that in four or five years, we will be back on track automatically.

Normally, there will be political decisions to increase spending on education and so forth, but it’s institutions in the system that we are not stuck in an incremental trend towards increasing public expenditures and that gives you a completely different situation when it comes to re-prioritizing public expenditures. It’s easier to spend less on transfers and more on education, less on inefficient public services and more on research and development or infrastructure when you have an automatic pattern.

And in most other countries, you have a strong drift upwards on the public expenditures which automatically takes out your room to maneuver and that I think has to be fundamentally changed.

I also believe that a big difference between the US and the Europe policy debate, where the US tends to think that it’s only austerity in Europe, I think that has some fundamental reasons and one of them is that in Europe, people are much more depending on the welfare state.

If you look at the welfare spending, Sweden is almost 7, 8 percent higher than the US. I actually think that we have created a very good welfare model in Sweden, so I’m not showing this to indicate that we should cut our welfare spending and go to the US level, but the point is if you’re a Swedish parent and your kid is starting in school, you actually want the school to be good. You will not say, “Well, it’s a downturn so I will now, the first three or four years, there will be very poor education, but eventually there will be some education.” If I have a heart attack, I don’t want to hear that the output cap is very big and we cannot use public spending. I want to know that I have a good surgeon waiting for me.

So when we’re talking about credibility and the US debate, it has a lot to do with market credibility. For us, it has a lot more to do with the social contract. The Swedes are paying their taxes, the Germans are paying their taxes, the French are there paying their taxes also, to a lesser degree, but basically, because they believe that the social contract works.

The problem with high deficit and high debt is that the fundamental basis for this contract becomes shaken. If we’re going to do expenditure cutbacks, we know that that will hit the welfare services, education, and healthcare.

So to keep the trust level in society up, if you want to have a welfare state, you need to be fiscally conservative because if you’re depending on the markets and if your population starts to feel that this is not stable and long-term sustainable, you will start to get the trust level being reduced and the foundation of society not working as well as it could.

So there is some very strong arguments for a social market economy where you will have higher social spending, but then you also need to be much more cautious when it comes to fiscal policy and you have to work with the social engineering issues of how you create and deal with the structural problems of labor market that you normally get from high welfare spending.

Some of those problems can obviously be alleviated by active labor market measures, by eligibility criterias, with control mechanisms and so forth, but if we believe that the welfare state is a model that we want, we also have to do the social engineering work to keep it functioning and I will get back to that because I think that is a key problem for Europe.

So this is challenging times for Europe. It’s a banking crisis, it’s a debt crisis, but it’s fundamentally also a structural crisis. And sometimes I’m not certain that US economists really understand the difference between Europe and the US. If we look at the structural unemployment rate, I think basically, these are the numbers from the OECD. I would argue that
most US economists would say five, six. Very few people probably would say about six. Some would probably argue that you could potentially even come down a little bit.

For the euro area, the structural unemployment is close to 9 percent. Very few people would say—I never met a European market economist that would argue that the euro zone could have 5 percent unemployment without creating fundamental resource problems and inflation, depression, and this has to do with very fundamental differences of our societies—the strictness of employment protection. Sweden is slightly below the euro area.

I don’t believe in big overhaul of employment protection. I don’t think that there is a very strong case for us doing reforms of our labor market but rather trying to find incremental changes together with our social partners, but it’s quite clear that the employment protection in the US is fundamentally lower and that has some implication for wage setting, labor market flexibility.

And also if we look at marginal tax rates, it’s come up a little bit in the US, but using different measures, one should clearly see that there is a difference of some 5 to 10 percent in marginal tax rates on average between a normal European country and the US Sweden is slightly below the euro area but clearly also above the US.

Product market regulation, there you can clearly see that there is a big difference and that is important for labor market. In any normal NAIRU equation, you will have a learner indicator, a product market indicator where more product market barriers and product market regulatory creates labor market inflexibility.

So from a US context, there is the argument that there could be a lot of fiscal stimulus in Europe. Well, I would disagree partly because what I’ve said about Germany, but also because the real issue in Europe is structure. It’s about the labor market. It’s about getting the labor market functioning better; not go to a US Anglo-Saxon labor market. They actually strongly believe in the [inaudible 00:28:01] market economy, but we have to reform the labor market so we get higher work participation, particularly for women. Many of our European countries are seeing women for work participation down at slightly above 15 percent.

I would guess that you have a GDP potential for gender equality in Europe around 20 percent of GDP increase if we would see maybe a kind of a Swedish labor market for the whole of Europe. I would guess that you would actually increase GDP something like 20 to 25 percent.

So in the US, the demand policy is more likely to be efficient because there is a flexible supply side that works and takes the demand without bringing up inflationary pressure. In Europe, that’s not the case and you should fix the fundamental problem when you deal with economic policy. The fundamental problem in Europe is an over-regulated inflexible labor market with a welfare state where work incentives are not strong enough and that would be the kind of core argument.

So what Europe should do is to really confront its fundamental structure problems. The first part of that has to do with fiscal policy. I think we’ve done enough when it comes to building a stricter budget process. What we now need to do is to create also a flexible process where we can actually use fiscal policy as a tool and that is something that one has to work through very, very carefully.

But then I think the structural issues should be on top of the agenda. If you look at a country like Italy, the cost level with some maybe 25, 30, 35 percent, depending on the measurement that we are using, in increase over Germany, France is doing pretty well when it comes to the manufacturing sector but in the terms of domestic sector, they look very much like Italy in terms of costs.
How can this be fixed? Obviously you need to deregulate your service sector. You need to open up your domestic sector for competition. Barriers of entry has to be cut down. Hinders for competitiveness, price regulation, entry regulations, all of this has to be reformed so you get a much stronger base for total factor productivity.

Let’s remember that some of these European countries have seen total factor productivity in the neighborhood of zero to a half percent over the last 10 to 15 years and that has to do with an over-regulated domestic sector.

Obviously some of these structural reforms can also strengthen public finances. Pension reforms being obviously that but also early retirement, sickness benefits, and unemployment benefits need to be reformed in some of the European countries.

It's not that we don't need welfare transfer or welfare services. The case is that you have to reform them so that you can provide good economic security while strengthening the work incentives. It has a lot to do with social engineering rather than just cutting back benefit levels.

And Europe also must tackle its labor market problem. I’ve spoken quite a lot of that, but that I think is the key, and increased hours of work, four hours, evolving the social partners. We have now seen deals between unions and employers in both France and the Netherlands. In Sweden, we’re working very heavily on the same kind of process, increasing flexibility while also putting more resources into getting people back to the labor market.

And then eventually, we have to strengthen the institutional framework. I will argue that we have to do this but one should realize that there is a quite problematic democratic issue that has to be dealt with. If you have a monetary union, it’s very logical that you have to create a banking structure, a banking union, where the features have to be supervision, deposit insurance, resolution and that has to come into place.

Having said this, I would still argue that we need to also take into account the functioning of the whole union and also of the democratic legitimacy. It’s not possible to my mind to see big transfer payments moving in Europe without creating political problems that would to my mind, undermine the political stability of the European system.

I don't believe in creating a situation where we have populist parties arguing against Europe in almost all of our major European states. So there is a need to work on the democratic legitimacy and to take this step with a strong ownership from the different countries when it comes to moving forward.

So a summary would be for Europe, there is a fundamental need to improve competitiveness and to improve the functioning of the economy both in terms of opening domestic service market to competition, but also in terms of improving the functioning of the labor market.

And I do believe that we should reform our fiscal policy institutions, so that fiscal policy both can be an active policy instrument while we’re also seeing long-term depth levels coming down to what has to be sustainable to have a stable and a credible environment for fiscal policy.

So that was the main message today and I would be very happy to take questions and remarks and comments, so thank you very much.

C. Fred Bergsten: Anders, thank you very much. I thought I gave you a glowing introduction and you outdid even my somewhat hyperbolic presentation of you. It was fantastic. You put an enormous number of things on the table.
Let me just start with a couple of questions and then open it up. We’ve got an awful lot of knowledgeable people here. You talked an awful lot about Europe understandably, your own country understandably. Let me ask you a little bit about the global economy.

You’ve been finance minister seven years, you’ve seen now a succession of problems and crises and as you mentioned yourself, we’ve had crisis every two or three years for the last 20. Is something wrong with the global economic system? Are there changes that need to be made at the multilateral, international level, that could arrest this deterioration one would have to say of global stability in a way it affects all of our countries?

Anders Borg: Well, I think we should realize that we are in the midst of a great transformation. The IMF has done a [inaudible 00:35:00] report that I think has some very, very interesting data. If you just look at export adjusted global labor force, people participating in the world economy, there has obviously been a tremendous increase over the last 20 years, but it will be as big increase for the next 20 years when the rest of Asia and also Africa is going into the world markets and more people in Latin America is also entering.

So there is a fundamental structural change. I think these structural changes also bring on a lot of uncertainty. It has impacts on financial markets and evaluation and creates a climate where bubbles are more likely to occur because one of the reasons why you have bubbles is that it’s very difficult to assess the real underlying productivity and therefore also real underlying return for an asset. So in such a fundamentally transforming time period, I think it’s quite reasonable to think that we should have a lot of turmoil.

Having said that, I also think we have a fundamental need for banking reform. I don’t think that the work has been more than half done so far. We need to continue to increase capital requirement for quite some time. In Sweden, we are heading for 12 percent. I don’t think that will be the end of the road. We’ll probably try to push the banks further. Risk waits for risky activity, trading or [inaudible 00:36:29] commercial property I think will have to be adjusted upwards.

The whole discussion of the [inaudible 00:36:35] report, what has been done here in the US about trying to create banks where you separate risky activity or at least demand more capital for risky activity I think is also continuing.

The banking system has a fundamental role to play in economics. The transformation of short-term liquidity to the long-term loans, the life cycle of adjustments and so forth, all of these roles are legitimate but the costs and the turmoil that this financial system has brought over the last 20 years I think makes it very, very clear that we have to deal with the financial system. We are far from finished with that to my mind. I think we will see continuous strengthening of supervision and tightening of regulatory structures on the banking system.

But fundamentally, we should be optimistic about the world economy. I mean, the growth numbers that we have over the last 20 years are fantastic. China, Latin America, now we’re seeing Africa. I think in the WEO, we have at least eight or nine African countries with above 7 percent growth. Market reforms, they can qualify for [inaudible 00:37:46] for Europe. They have 30 percent depth level and the deficits are close to three. They’ve been able to go through this crisis without building a fundamental instability.

There is an in depth study from the fund showing that this time around, the fundamental setting for the low-income countries are much better. So fundamentally, the world economy is doing pretty well, probably better than it ever has done but it’s more turbulent and the financial system has to be fixed.
C. Fred Bergsten: Let me ask you a question about the politics of what you just described. You stressed in talking about Europe, the need for democratic legitimacy with the institutional reforms. Again, sticking to the global level, you talked about this huge increase in the world labor supply, it’s going to continue in a couple decades, this is all in the emerging markets and developing countries. How do we get them to step up to play the kind of role in helping lead and manage and take responsibility for global stability that we like to think the US and Europe have done for the last century, but these guys are going to have to do for the next century?

Anders Borg: Well, I mean the concept that Bob launched of partnership and cooperation with China and China is a strong responsible global partner, I think I strongly agree with that. If you look for example at the World Bank report on China's long-term issues where Chinese authorities and World Bank authorities work together, what you're basically seeing there is a move towards more of an open democratic and market-oriented China.

If I would have talked to Swedish business multinationals five years ago, China would only be paradise. Today, they are aware that corruption is a major issue. They understand that you cannot deal with corruption with democratic reforms. They realize that there is a fundamental environmental problem that has to be dealt with. There is a Gini coefficient inequality problem that has to be dealt with, which is also true for many of the other low-income countries. So obviously reforms are necessary.

But I also have the sense that there is an understanding of this among at least the Chinese leadership. There's a maturity in their world view in terms of where China is going. On China, I think one should fundamentally be optimistic, then you obviously have issues of nationalism, and environmental problems, and corruption that eventually has to be dealt with. But the answer is for them I think more democracy, more openness to have the strong growth, not as a dragon growth but to a solution to some of the legitimate problems that is quite clear.

C. Fred Bergsten: Okay, let’s open it up. Bob, you want to take that entrée and ask the first question?

Bob: I want to thank Anders for taking the time to come over. That was an excellent presentation and I certainly learned a lot. I got a couple quick questions. I mean, there’s so many I could ask but one, you touched on France, you’re also a student of political economy. Obviously in the history of Europe and the euro zone, Franco-German relationship is very important. At least the sense I get from talking to German business and political leaders is a lot of anxiety about whether France so maybe you could expand on that.

The second is, you make a very good case that if you want to have a welfare state, you need to have a fiscal conservative policy. I hope you’re talking to President Obama too on this. But I think the question then is the politics of reform in the South. So I can sketch a model through strategy, I can follow your logic but what I’m increasingly uncertain about is how long the politics of this can last? When you look at the decline and output, they’re really matching the types of conditions in great depressions or after wars and to extend this for a decade, I just don’t know whether the political system can sort of manage that.

And then third, while your presentation is on fiscal, a lot of people here have been focusing a little bit on the monetary and without getting into all the aspects of it, let me just put this question. Without necessarily being critical of monetary authorities yet, there’s clearly the chance that we’re planting the seeds of another future crisis here.

And it was interesting, Martin Wolf’s piece this week, he was talking about, “Oh, we don’t have inflation.” He’s doing the same thing Greenspan did. He’s only looking at goods and prices; not looking at asset prices, okay? And as I look at asset prices, bonds, sort of equities, farm land, I get a little nervous. So what do you see on the monetary side and planting the seeds of a future crisis?
Anders Borg: Well, I would actually be on a slightly different take than you were, Bob. I think it’s good that Bank of Japan now has done what they probably should have done 20 years ago. If you are at zero bottomless problems with an asset vicious cycle that they’ve been in that they should have dealt with the banking system as we all know in a much more efficient manner, but given that they didn’t do that, I would argue that the fact that they are now pushing the yen is a very reasonable response for 20 years of deflation.

And given that the US monetary authorities, I mean, one of the best pieces on this is actually written by Ben Bernanke, for me, it’s very strange that the US government is starting to raise issues with competitiveness, devaluations from Japan. This is what all US authorities have asked for from Japan for the last 20 years and they are now finally doing what is reasonable. They need to get inflation going. I’m a friend of [inaudible 00:43:34] and so it’s a strange feeling to say that, but in Japan, you actually need some inflation.

They also need fundamental structural reforms quite clearly. The labor force participation, they have the world’s best educated housewives, which is obviously not very efficient.

When it comes to Europe, I would argue that the risk of price inflation is very limited. There’s basically very limited wage growth and if you look at unit labor cost for a big closed economy, which is probably the best and most important indicator of inflation, is extremely low in the euro area. Even the most—on the high side forecasts are well below 2 percent.

So I would argue that it’s more worried that the central banks, at least in Europe, I mean, it’s different with the US I mean, you’re further away into the recovery. But in Europe, how can we solve, square the problem with contractionary fiscal policy in Southern Europe, deep structural reforms to increase productivity with layoffs. I mean, look at Spain and Greece. Fundamentally reforming your domestic sector will cost jobs.

So under those circumstances, with open output caps and the need for contractionary, at least not expansionary, fiscal policy, it’s quite obvious to me that you need to have support from monetary authorities at least in Europe and Japan. You could argue that the US might have some bigger problems but even here, I would argue that it’s quite—you’re quite long away from being at the long-term unemployment.

When it comes to France, I think the government, the Minister of Finance Moscovici is trying to move them in the right direction. The article four report from the fund has a very, very telling number of charts where you’ll clearly see that in terms of labor cost and productivity, in manufacturing they look like a twin to Germany, very, very similar; not fantastic productivity, but very low-wage increase over the last 10 years which means that they’ve done decently well.

The domestic side, it looks basically like Italy. So the domestic sector in France is completely over-regulated and inflexible and that has to change because no economy can bare global competitiveness with a large inefficient and costly domestic sector anymore. That could have been an alternative 20 years ago, but today I think the cost pressure from the domestic sector feeding over to the export sector kills off your competitiveness. So I think France needs to do quite fundamental reforms. I think they are very much aware of this.

The political economy, well then I’ll actually go back a little bit to the monetary side. I cannot see how Spain, Italy, Greece, Portugal can go through this and obviously also Ireland, without having support from the monetary side. If they are going to live through a period of not only restructuring of public finances, but also fundamental productivity reforms in the domestic sector, the only way to get that reasonably well-functioning is to have a very expansionary monetary point.
The problem with this is everybody seems to need devaluing currencies and expansionary policies. But there is a risk in this and that might be what you’re also referring to that we might get into something like in 1994 situation that when the US started to tighten or stopped doing quantitative easing, you could see a heavy reaction in the financial markets where the bonds sell off and moving into a US equity can create some quite problematic and turbulent situations.

C. Fred Bergsten: I can’t resist asking a quick follow-up question then I’ll go to Joe. You just noted that everybody wants to devalue and then your remarks, you said within one breadth Sweden’s running an 8 percent current account surplus, but we sure do not like that upward pressure on our exchange rate. Because the 8 percent surplus doesn't accept some appreciation, how does everybody get accommodated?

Anders Borg: Well, I mean, it’s quite—it is to some extent I think a structured situation. It was only last year that we become net balanced in accumulated current accounts. So we built up huge current account deficits in the 70s and the 80s. So we don’t have a large positive net position like Switzerland, or Norway, or South Korea. We are basically in long-term balance.

I cannot see why we should run 7 percent current account surpluses, but that’s not something that we appreciate, or target, or in any way see as something good. The problem though is that if you have an industry structure, which is very commodity based, particularly paper and pulp industry where you also have news prints going down and news print prices are going down, it’s quite clear that we will some quite difficult structural changes in our industry because they have become used to having a soft currency and it’s very difficult to see how the krona would do something else than gradually and socially appreciating in the years to come.

So for us, that will be a drag on growth I think and eventually will also mean that the current accounts will go down.

C. Fred Bergsten: Okay, Joe.

Joseph Gagnon: I’m Joe Gagnon with the Peterson Institute. You actually partly answered my question when you were talking about monetary policy, but let me state it anyway and maybe you can go further. I can’t speak for all US economists but certainly I know many of us actually do share almost exactly your interpretation of the structural issues in Europe and structural reasons why unemployment is high in Europe. And I mean it seems to me although you seem to hint that, I don’t know if you would agree with this, that part of the problem in the last three years is that there’s been too much focus on the fiscal adjustments in the past three years and not enough on the structural adjustments.

I mean, they have both been talked about continuously, but if you just read the reports in the press, you can’t help but have the feeling that the structural changes so far have not been nearly as aggressive as you would like while the fiscal movements have probably been more aggressive than you would like and I wish the balance were different. I wondered how you would feel about that. I know that in particular, you talked about the structural rate of unemployment in Europe as being very high at 9 percent, but of course the actual rate of unemployment is 12 percent, which is an enormous output gap, especially when you consider the rigidities that prevent firing in Europe that means that GDP gap is much, much bigger there than in the US.

So wouldn't it have been better to have rebalanced the past three years towards more structure reform and less fiscal consolidation? And could that have been done, should not the ECB have been less conditional in its OMT [Outright Monetary Transactions]
and more willing to finance some slower fiscal adjustment? And then of course maybe that would go along with easier monetary policy. It seems to me that's what American economists are concerned about. It's not the structure. We understand the structure. It seems to me we understand the structure problems, but relative to the structural position, there's a huge output gap there that would be a minimal to policy.

Anders Borg: Well, I agree with basically everything that you're saying. If I was a US economist, after the crisis with the Lehman crash, it was quite obvious that there was a severe demand contraction and expansion in monetary policy was called for and so on, very reasonable.

The problem in Europe is that if you spend 60 to 70 percent of the time in the US talking about demand and house prices and so forth, in Europe, we need to spend that 60 to 70 percent talking about the structural issues, how to get the regulatory barriers down, how to strengthen entrepreneurial climate, how to improve our education system and how to bring innovations into actual market production and this is particularly true for Southern Europe.

So I think the basic feature of the crisis was a banking crisis in 2008 that gave a shock that clarified that Southern Europe has priced themselves out of the market in a 20-year process. Part of that has to do with lack of monetary control in the currency union, because it's quite clear that cheap credit steaming from interest rate convergence has pushed the construction sector in Spain and it fooled the Greeks to believe that they were much richer than they were and so forth.

But fundamentally when you took that away, there is a huge productivity problem. I think the total factor productivity from the OCD of Spain is minus 0.2, 0.3 since 1995. We all know that wealth is total factor productivity. You cannot run an economy with almost close to zero total factor productivity without getting into serious imbalances. That's not possible. So in that respect, this is fundamentally a structure problem.

I would disagree on the fiscal side. When France now is getting another year and Spain is getting another year. If you go like in Spain from 10 percent deficit in 12 to 7 percent in 14, I wouldn't say that that's fiscal contraction that is exaggerated. I think you're basically doing what is absolutely necessary not to run up a depth level that would be unsustainable in the long term.

The world markets are accepting the US as a safe haven. So you can see 10-year bond rates running around that are close to or even below 2 percent with a high depth level. And we all should be happy if that continues because the day when the depth market is starting to think that can we really trust the US? Then we will be in deep problem. So I also believe that the US has to deal with the depth problem even if it's not that acute.

And I also agree with your third point that it's quite important that we keep monetary policy expansionary in this environment. I think that the logic of the ECB was it's quite clear that the Spanish have almost a program. They do everything the commission and the fund is arguing for. So if they just ask for a program, you would do it like that. You would just assess the current policies and say they are along the lines of what is necessary and then you could start the OMT, fine.

But how do you deal with Italy if you don't have a government? So conditionality is good but if you run into real problems, in this case you probably have to throw out the conditionality out the window and just continue with expansion and monetary policy—and I think [inaudible 00:54:59] has been a major shift in his commitment to the euro project has been a major shift in the sentiment of the markets, but that has to continue and eventually I think they will have to deliver on their promise and do more measures to stabilize the bond market.
C. Fred Bergsten: Herbert? Good friend Herbert Oberhansli from Nestlé, from [inaudible 00:55:24].

Herbert Oberhansli: Thank you for an excellent presentation. First point, you now quickly mentioned the euro but it didn't come up very much and let me ask indirectly. During the worst time of the crisis, was it an advantage for Sweden to be not a member, or disadvantage? How do you see that?

Second point about the debt situation of particularly also European countries that the big elephant in the room are the contingent liabilities and there is quite some intransparency.

Bank for International Settlements did some estimates, you probably know them. France up to 2040 debt ratio to GDP going up to 400 percent even if they keep age-related payments stable, which will mean cutting the pensions off if the number of old people increase, still an increase to 200 percent. So an accounting of the states, which is medieval basically to say, company couldn't do that.

So how do you see how to address that, first the transparency issue then the political issues which are much bigger than what probably is right now discussed and then the probably easier question about the euro and Sweden with the krona during the worst stage of the crisis?

Anders Borg: Well, if you look at Finland and Sweden and you take out the fact that Nokia has not been success, there is huge similarities. Unemployment is moving basically together. Industrial production is moving basically together. GDP numbers look almost the same and Sweden and Finland are quite similar. We have quite similar industry structure. We are a little bit more diversified and a little bit bigger but basically very similar. So you cannot say that the Finnish experiment has shown that they have had a much worse economic development than Sweden.

Quite clearly in 2008 when the Krona depreciated very strongly from 2008 autumn to spring 2009, that was beneficial. That was a buffer for our economy. At the same time, when we are now—our depth level is 40 percent. We have the lowest inflation number in Europe, very credible central bank. We have had a total factor productivity that is basically well above the rest of Europe. I would argue that we've been on—the last 10, 20 years, you've seen growth around 2.5 percent in Sweden.

So it's not very likely that the currency will stay weak. It's more likely that we will get the opposite problem. The Israeli, Chilean, South Korean, Switzerland problem, that you have a currency that becomes overvalued and that's quite problematic for an export-oriented country like Sweden with a strong manufacturing industry. We are not Switzerland. We are not in pharmaceuticals and banks. We are in paper, pulp, trucks, high techs, drilling rigs, oil construction, we are basically kind of a mini-Germany in terms of manufacturing products. So for us to have a development where the exchange rate is drifting away could be quite problematic.

And let's remember that we have a very modern banking system so 50 percent of the financing is exchange-rate related, wholesale financing. We don't have direct taxes, neither the dollar or euros. So the Riksbank is now increasing their reserves. I think we will probably have to find a construction where we are taxing wholesale bank financing in currency and put that into the currency reserve. We need to build much stronger currency reserves moving forward. The Riksbank has done a tremendous job to take them up but I think we need very strong currency reserves in this situation if we're going to stay outside of the euro, which seems to be very likely given the population is 80 percent against joining. So we will stay out for quite some time.

It would obviously be much safer to have a big banking sector inside of the ECB umbrella, but on the other hand, we will have to deal with it. We will have to make it stronger and increase capital requirements.
Well, I don’t think we should say that the problems in France, in Germany and other European countries are unsolvable. I mean, we are becoming a lot older, but people can also work longer. Why should we have a fixed pension age that was set when the average of the population was below 60 and continue with that when people are living—most kids today born in Sweden will live past 100 years.

So they cannot go into pension when they are 65 and this is also true for Germany, and for France, and all of the other countries, and I think it’s very reasonable to convince the voters that we need to have some automatic balancing in the pension system and it should not be that we’re cutting pensions. That’s not the welfare optimum solution. I think it’s much more better to increase pension age. Healthy people can work much longer.

I mean, in Sweden we are seeing the strongest employment growth now above 60 and to a large degree, we’re seeing people with better education, staying on the labor market well above 65 and why not? I mean, if you enjoy your job and if you’re having a good time at work, which is the kind of job that I have, I mean, why go home? I would never stop at 65. I wouldn’t even think about it.

C. Fred Bergsten: I was saying to Anders that I’m turning 72 next week and I’m now back working full time again in the institute and looking forward to decades more of good success. So I’m an example of what he’s talking about. Jacob.

Jacob Kirkegaard: Jacob Kirkegaard from the Peterson Institute. Two quick questions. I noticed when you were talking about the banking union and the importance of it; you also said “we” are building a banking union. Should I interpret that as if Sweden intends to join the banking union, and if so, when at the same time you talked about 12 percent capital for banks in Sweden, which I would interpret to be quite a lot higher than what will be the European average, what will be the conditions for that Sweden would need to have sort of squared away both with respect to joining into a structure like the ECB when non-euro members are clearly, not directly or actually by the treaty, not allowed any influence? If you could talk a little bit about that.

Second quick question: You talked a lot about the democratic deficiencies in the European project and I think it’s something that I very much share and my question then is that when we think about the centralization, the necessary centralization in some ways, which I think you also alluded to on for instance things like fiscal surveillance, the six pack, the two pack, the European semester, et cetera, the degree of transfer of fiscal sovereignty if you like to the European commission that has already taken place, is that in the long run politically sustainable or does it actually in the long run, and by that I say it’s five to 10 years, require a fundamental change of the political institutions in especially the euro area so that you transfer more direct democratic accountability to these centralized institutions in Brussels?

Anders Borg: To start with the banking union issue, the structure is that ECB is the supervisor. The legal structure is such that the ECB council, where only ECB member states are part, have voting rights. So for a country outside euro zone to join would mean that when things get really rough, Sunday night at one o’clock when you have to close down a big bank or cut up the big bank and you have three hours to do it before the Japanese market open, then it matters who votes. It really matters who will take the punishment and how the decisions are made when we’re talking about quite a lot of money. So I cannot foresee us joining until we have equal standing in the council.

Therefore, I was very much—I think we saw some progress at the ECOFIN last week because we, but primarily the Germans, we were just supporting them a little bit, said that this has to become treaty change because if we get treaty changed, you could have equal
standing and you can have a firewall between monetary policy and supervision, which is what the Germans are asking for. But if you have the firewall, it’s also quite obvious that all the countries that are in the system can vote on equal terms.

Then you have the issue of banking resolution and deposit insurance. Sweden has a peculiar way of dealing with banking crisis. We are actually only willing to put tier-one equity into banks. If a bank runs down in capital, we will take it over. We don’t believe so much in the bail-in side of things because if you have a system where you take over a bank when it’s bad, that bank is back in the market the day after. The day after [inaudible 01:04:53] opened off their Iceland collapse, we did not have any people standing in queues because we had taken over the bank. We have resold it to the market. We actually made some profit on that, but there was no run on the bank, there was no liquidity problem for the rest of the banking system, not even in the morning. It was everybody knew exactly what had happened. Iceland had collapsed, we took over [inaudible 01:05:14]. Depositors were clear that they would get their money.

If you start to get on the financing side of banks, you might get into a problem that you have one bad bank, but that means that the average of the banking system is worse. So then you have another bad bank and then the average is even worse and then you have a negative spiral. So I think we need to work with an equity tool when it comes to crisis resolution. We’re not there yet so I’m a little bit worried where we’re heading when it comes to banking resolution. It cannot be that we are thinking that the state only can take over bad assets or put banks into transition companies that would then be returned to the owners. If a bank goes bust, the state should take it over and then resell it and earn a profit so that you safeguard taxpayers’ money.

I know that this is controversial here in the US. Banking socialism I remember was the word in 2008 and '09. It’s very controversial in France and Germany so they’re very reluctant to it but I think we need to push this case further. So it will take some time before Sweden is in the banking union. It needs a treaty change. So therefore, I think we need to strengthen our banking system outside of the system and I said 12 percent, I’ve not said, that’s not the end of the road. There are also contra cyclical buffers and so forth and I think we really need to have a strong banking system.

C. Fred Bergsten: Andrews.

Andrews: Thank you very much, excellent presentation. I would like to follow up a bit more on what Jacob said here about your attitude to the European Union as a whole, how you see it developing and how you would like to see it developing.

Do you see it as being three rings, one the EMU [Economic and Monetary Union], other countries like Sweden, Poland hanging outside a bit, and then Britain be almost completely outside or do you see Sweden and Poland coming in to the heart? So that’s one part of the question.

The other, we are now seeing a clear division between the north and south. Europe is no longer divided east and west, but north and south, and because of all these support programs, the south doesn’t have many votes in many discussions and this could give a possibility for the northern free traders and fiscal conservatives to impose their views. How far would you like to go in that direction and eventually of course we come to the question of a more federal system that in particular [inaudible 01:08:03] is now campaigning very strongly on. How do you see the EU developing?

Anders Borg: Well, first and foremost, a currency union will only work if you have fundamental flexibility in the labor market and an ability to adjust productivity. So it cannot work where
some of the countries have zero productivity rates because that would force the rest to have also zero otherwise you will build up eventually big cost differences. So you cannot have part of the union growing in much lower productivity rates. So therefore, the need for opening up markets and to reform the economic system comes directly from the currency union otherwise it fundamentally is unstable.

You also need a much bigger ability to adjust also in the labor market. Labor market flexibility and adjustment of use of resources has to be better if you're in the currency union. Fundamentally, I think these are reasonable arguments for having the currency union. It forces people to be more efficient, gives better long-term productivity growth and therefore better welfare.

The problem though is that you also need them to have a stable financial system. So you also need to fix the banking side of it. It has to be some kind of banking union, resolution schemes and so forth. I don't know about the fiscal transfers. If you fix the productivity in the banking side, some people are saying that the big difference between the US and Europe is that you have all of this fiscal transfers in the US.

That's a very strange argument. When we were talking about high productivity growth and low unemployment in the 90s of the US, nobody talked about fiscal transfers. They talked about a flexible labor market. The dynamic entrepreneurship of California and Silicon Valley, the IT sector transforming the US economy.

So I think one is overstating the enforcement of transfers in the US, and I don't think that you could have a political sustainable support for a transfer union in Europe. So therefore I think you need to deal with it with setting the fiscal framework right so that you're not getting this kind of external effects.

But obviously, then you need also to have the crisis part of it and that I think, there you have a role for fiscal federalism that you're ready to support countries that have run themselves into trouble, obviously with conditionality and together with the fund and so forth, but there is a crisis resolution role where the ESM is I think a very reasonable instrument to use.

I don't believe that Europe will become the US in terms of federalism. There is no political support for that in any European country that is widely based. If you would have a referendum in Germany and ask whether they would give up their German-ness, or particularly the French, they would not be willing to giving up the sense of being French and becoming only Europeans. So therefore, we will have to do this in a gradual and pragmatic manner, rather than trying to see this as a future nation. It's not a union between nation states because it also has legal implication that is of course much on, but it's not either a federal system.

C. Fred Bergsten: Nikolai?

Anders Borg: Can I also get back to the UK? I think it's a key interest of Sweden and Germany to keep the UK in. UK is the most populous state in 10 years in Europe. It is one of the most dynamic economies and it fundamentally is the financial system of Europe. We don't have two financial, big financial—we have one and it's very difficult to see that it would the financial New York in one jurisdiction and then the manufacturing, Sweden, Germany, and Netherlands in another jurisdiction. So this has to be one jurisdiction I think.

It's a key interest I think from all of us to keep the UK in. Also I think in the long run, Francois agreeing on this issue that we need to keep the UK in our union. So the cooperation between the countries outside has strengthened tremendously over the last six months, to Sweden, Poland, and Czechs, the Danes are now cooperating much stronger
than we ever have done before, because we need to have somewhat more of a balance between the EU-27 and the euro area. But we are cooperating in a pro-European sense and pro-European spirit. We are not cooperating against the euro zone, but cooperating to have a strong European Union also.

C. Fred Bergsten: So on the UK, will the current union give Cameron his meaningful renegotiation?

Anders Borg: Well, the US-EU free trade agreement is the best thing that will happen to this issue. If we would see a strong European/US free trade agreement, that would vitalize the single market, vitalize growth in Europe, and also show to the UK that this is where you have home, this is where you have the positive reforms in terms of growth. So I think the fact that Barack Obama clearly stated that the US is interested should be met from Europe with a very strong interest of moving forward with the free trade agreement.

So in that respect, I think we will have to load EU, the euro area, with much more growth contents to keep the Brits in. Yes, I do think that there could be a compromise where you'd do some treaty changes. I don't think that the Brits can fundamentally renegotiate the treaty, but if there is a need for some symbolic issue, yeah, that could be done.

C. Fred Bergsten: And you’re also saying that the transatlantic trade agreement would give Cameron something of an excuse to stay in.

Anders Borg: Most definitely, not only an excuse but a very, very strong argument.


Nikolai: Thanks minister for what was a very impressive presentation. I have two questions, one of semantics and one of perhaps more substance. The question of semantics is that in one of your slides you mentioned economic union and I would like to—in a way, you expanded on this, but I would like to ask you specifically what you have in mind when you talk about the economic union because my experience had been that different people have different things in mind when they talk about it.

The question of more substance is I was struck by how you answered Fred's first question on to global challenges by insisting on financial and banking regulation. At this point, it is clear that the European Union is in a different space from the US and the rest of the world when it comes to certain aspects of banking relation.

And I’m thinking of course, of the cap and bonuses, attitude to rating agencies, to financial transaction tax, a number of developments that we see gathering pace in a way, in terms of European financial regulation and I’d like to have your sense of where the EU is going and where the world is going in terms of financial regulation and what you’re happy with, what you’re less happy with. Thank you very much.

Anders Borg: Well, I have a pro-European starting point. I believe that European corporation is good for Europe. We are a multicultural, multi-ethnic and multi-historical entity of different cultures, which I like. I mean, Europe is really a building, a social market economy with strong cultural heritage that is a very sympathetic society to my mind, but it is where we’re at home. I mean, the political union of Europe is the kind of home for Sweden, home for Germany and there is no other place to be and so we have to be pro-European.

I would argue that the—I don’t have any original view on what we need in terms of the economic union. I mean, it’s quite clear you need the banking union in place, you need to strengthen fiscal cooperation, you need to invigorate growth to get the single market to work better.
I’m not certain that Europe is moving in its own direction when it comes to financial regulation. To my mind, I think the world is actually moving in the same direction, more capital, tougher risk rates, tougher resolution schemes, tougher demands on banks when it comes to payments and bonuses. Yes, Europe has been a little bit tougher on bonuses than the US, but on the overall scheme, I think we’re moving on different paths towards a more stable and more well-regulated banking system.

C. Fred Bergsten: Angel.

Angel Ubide: Angel Ubide from Peterson Institution. Thank you, minister. This was very interesting but I was struck by something you said. You said that you may need to accumulate more reserves, more foreign exchange reserves. Now, is this related to the fact that you feel your financial sector could be vulnerable to a liquidity, a global dollar liquidity issue and so it would relate to the issue of having FX [foreign exchange] swaps and other arrangements at the more central bank level, or is this because you feel that as a small open economy, you need a bigger insurance cushion that you can deploy at some point in case of a big crisis, or is it because you feel that because you have one of the best fundamentals out there, your currency will [inaudible 01:17:44] and duly appreciate and would lead to hollowing out of your manufacturing industry?

And if so is this the course of being virtuous, right, that maybe we are talking of a system which has exchange rates that are too flexible sometimes and that you need to manage that. Again, as I said, I was a little bit surprised about the statement about increasing the reserves, if could elaborate a bit more on the why.

Anders Borg: I agree with your first argument that we needed—of course, we have this wholesale financing structure. I think more countries are likely to move in that direction because it's not very rational that the households are only keeping their savings and deposits that they should go into other assets that's giving bigger returns. But if you have high degree of wholesale financing, you’ll have a liquidity problem so I strongly agree with that.

We have a big banking sector, which obviously makes it important for us to have resources. We are also building stability fund where the banks pay a bank stability fee, which is increasing quite rapidly that would be used for banking resolution but I think better reserves is better also in this respect.

And yes, I agree that there is a balance of payment, management problem where the central bank can play a role. I’ve talked quite a lot with the central bankers in other countries that has gone through similar problem, Latin America, Israel, and some of the Asians, it's extremely difficult to deal with such problems so I think more reserves is better than less reserves. In the textbook world, you don't need reserves, but in the textbook world, solvency and credibility doesn't exist either, and I have to be in the real world so I like reserves.

C. Fred Bergsten: Well, Anders, you’re deep in the real world and we deeply appreciate your sharing so much your thinking with us. As always, it's a fantastic conversation. We could go on for hours. We know you've got a lot to do here. We thank you very much for joining us once again at the Institute. It's great to see you and we look forward to staying in very close touch. Thanks again.

Anders Borg: Thank you very much.