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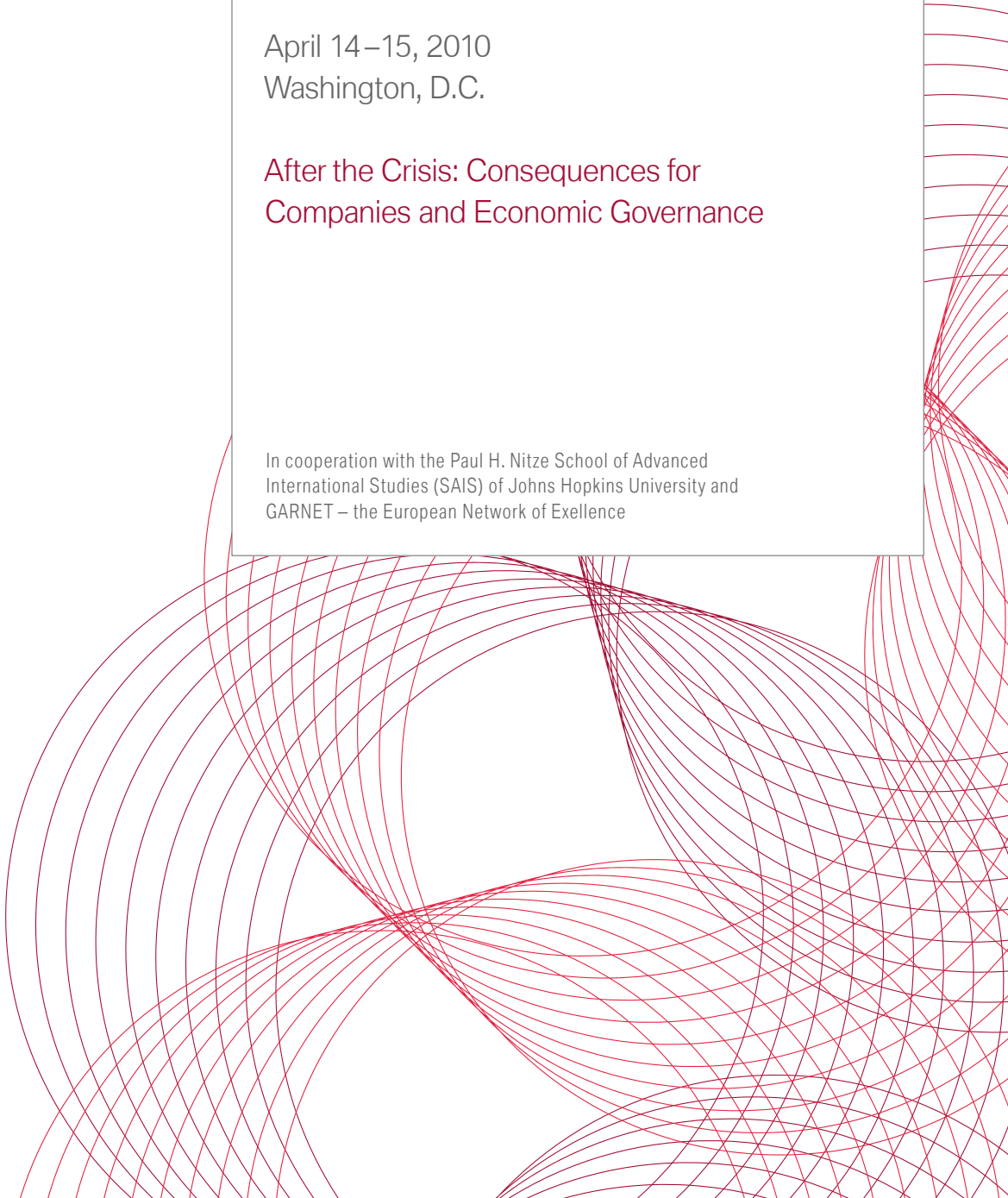
Herbert Quandt

3rd Transatlantic Economic Dialogue

April 14–15, 2010
Washington, D.C.

**After the Crisis: Consequences for
Companies and Economic Governance**

In cooperation with the Paul H. Nitze School of Advanced
International Studies (SAIS) of Johns Hopkins University and
GARNET – the European Network of Excellence



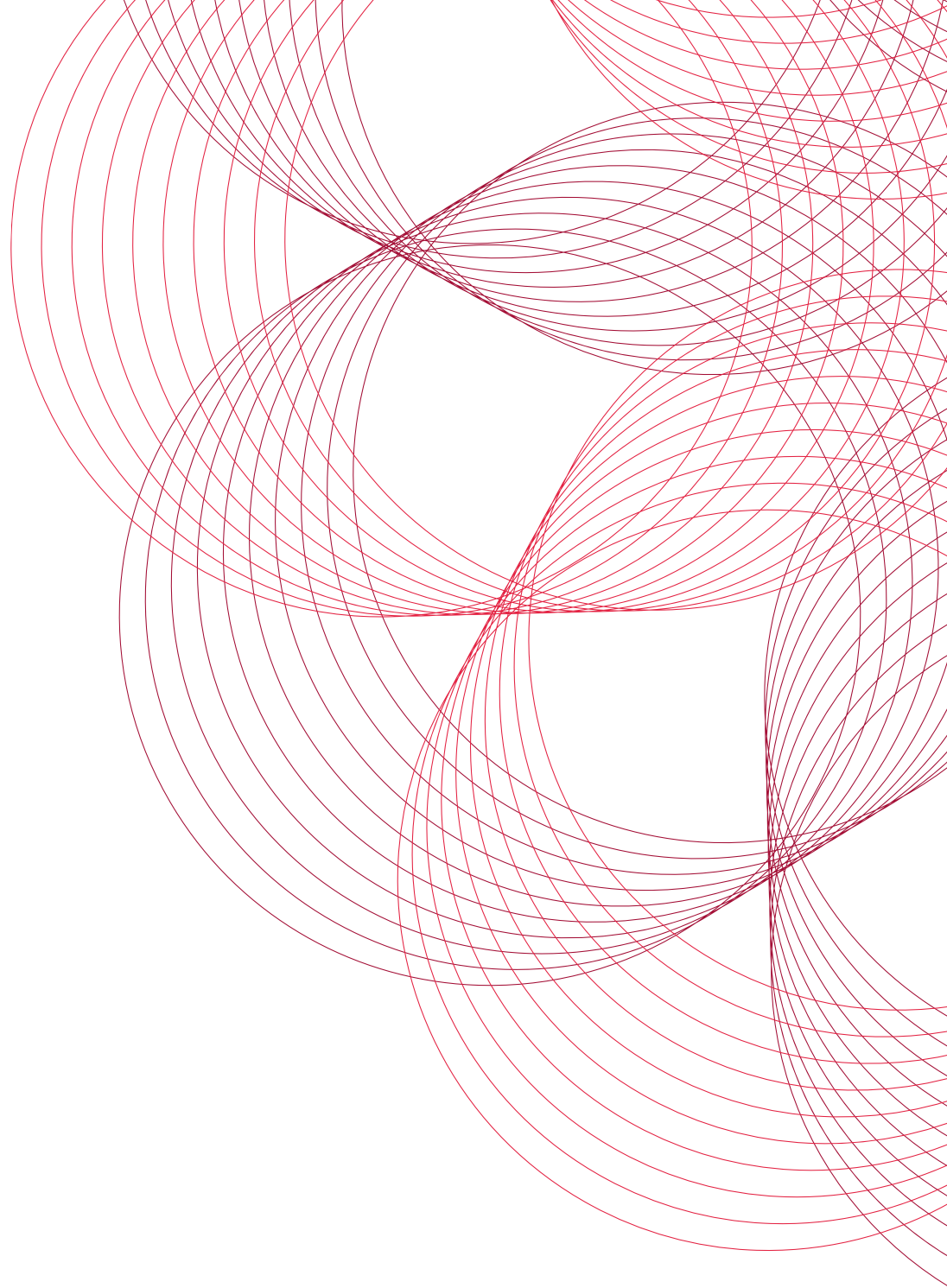


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Conference Program

Wednesday, April 14, 2010

Opening Dinner

Residence of the EU Ambassador to the United States, Washington, D.C.

by Invitation of the Chargé d' Affaires and Acting Head of the EU Delegation to the United States

Angelos Pangratis

Dinner Speech

Barney Frank

Congressman (D-MA) and Chair, Financial Services Committee, U.S. House of Representatives, Washington, D.C.

Thursday, April 15, 2010

Opening of Conference

Jessica Einhorn Dean

The Paul H. Nitze School of Advanced International Studies (SAIS), Johns Hopkins University, Washington, D.C.

Jürgen Chrobog

State Secretary (ret.); Chairman of the Board of Directors, BMW Stiftung Herbert Quandt, Berlin and Munich

Session 1 | Taking Stock: Where Do We Stand in the Crisis?

The global financial crisis appears to have been managed surprisingly well. Considering the doomsday predictions in late 2008 and early 2009, there has been a remarkably smooth development. We have neither witnessed a collapse of the global financial regime nor a dramatic rise of protectionism. In short, there has not been a repetition of the 1930s. Yet this benign development may turn out to be riskier than it appears. Whilst both the financial sector and producing economies have fared well, governments have shouldered unprecedented levels of responsibility and debt. Is this sustainable? How do we return to acceptable levels of government activity in the economic domain? What are the consequences of government-owned car producers and banks for competition policy? What are the exit strategies of the central banks? Will we pay for the crisis by inflation or by higher taxes? And what could diverging levels of inflation mean for international economic relations?

Chairman: Daniel Hamilton

Richard von Weizsäcker Professor and Director, The Paul H. Nitze School of Advanced International Studies (SAIS), Johns Hopkins University, Washington, D.C.

Speakers:

Richard Fisher

President and Chief Executive Officer, Federal Reserve Bank of Dallas

Jürgen Stark

Member of the Executive Board, European Central Bank, Frankfurt

Beatrice Weder di Mauro

Chair of International Macroeconomics, University of Mainz

David Wessel

Economics Editor, The Wall Street Journal, New York

Session 2 | Prospects for Financial Regulatory Reform

A key issue that continues to vex policy-makers is financial regulatory reform, especially the feasibility of more structured mechanisms for cross-border collaboration when global systemic crises erupt, and of global economic governance. National efforts at financial regulatory reform are unlikely to be successful without more effective international collaboration. How should such collaboration be structured? What issues deserve priority attention?

Chairman: Roger Leeds

Research Professor of International Finance; Director of the Center for International Business and Public Policy, The Paul H. Nitze School of Advanced International Studies (SAIS), Johns Hopkins University, Washington, D.C.

Speakers:

Otmar Issing

President, Center for Financial Studies, University of Frankfurt; Former Member of the Executive Board, European Central Bank

David Altig

Senior Vice President and Director of Research, Federal Reserve Bank of Atlanta

Mark Taylor

Professor of International Finance and Macroeconomics; Dean of Warwick Business School, University of Warwick

Session 3 | Towards a New Global Economic Governance – What Role for the G-20?

Up to the financial crisis, international economic governance was in dire straits. In particular, the G-8 appeared outdated and unable to contribute meaningfully to the governance of the global economy. Old institutions, in particular the International Monetary Fund, lacked support, and potential customers tried to avoid using the IMF's services. The crisis has led to a renewed interest in the potential of global economic governance. In particular, the G-20 is portrayed as the future forum for global economic governance.

Can the G-20 contribute meaningfully to the management of the global economy?

Is it sufficiently legitimate?

Are the member countries of the G-20 willing to shed sovereignty in order to avoid major turbulence in the global economy?

Are the producers of large current account surpluses able and willing to reduce these surpluses?

What will be the scenarios if China, Germany and Japan continued their preference for exporting?

Can the U.S. become a leading exporter?

What is the role of an international lender of last resort? Is the IMF sufficiently equipped for that task?

Chairman: Richard Higgott

Pro-Vice-Chancellor for Research, University of Warwick

Speakers:

Heribert Dieter

Senior Fellow, German Institute for International and Security Affairs, Berlin

Johannes F. Linn

Director, Wolfensohn Center for Development, Brookings Institution, Washington, D.C.

Thomas Mayer

Chief Economist, Deutsche Bank Group, Frankfurt

Session 4 | North America and the EU in a G-20 World

The crisis weakened the position of the OECD countries, both with regard to the relative size of their economy and, even more important, with regard to the credibility of their economic strategies.

Are emerging countries emancipating themselves economically and intellectually from the old transatlantic world?

Is the emerging world developing new forms of cooperation outside the existing structures of economic governance? Will the BRIC meetings become more important?

How should North America and Europe reposition their relationship to a G-20 world?

Chairman: Heribert Dieter

Senior Fellow, German Institute for International and Security Affairs, Berlin

Speakers:

Richard Higgott

Pro-Vice-Chancellor for Research, University of Warwick

Daniel Price

Senior Partner for Global Issues, Sidley Austin LLP; Former Deputy National Security Advisor for International Economic Affairs, The White House, Washington, D.C.

T.J. Pempel

Professor of Political Science, University of California, Berkeley

Concluding Remarks

Jürgen Chrobog

State Secretary (ret.); Chairman of the Board of Directors, BMW Stiftung Herbert Quandt, Berlin and Munich



Conference Summary

Introduction

Welcome to the 3rd Transatlantic Economic Dialogue! One year ago, at the 2nd Transatlantic Economic Dialogue in March 2009, the future of the global economy was very uncertain. Policy-makers and managers were concerned indeed. Confidence, this main ingredient of growth, plummeted. In 2010, cautious optimism has returned.

We are looking back to the turmoil of the second half of 2008 and the first half of 2009, and the great crash has not happened. But this year, we are already confronted with the next crisis. This time, it is not the financial sector that is in trouble, but rather governments themselves. At this year's 3rd Transatlantic Economic Dialogue, we want to reflect on the crisis and its consequences. One consequence is quite obvious: The center of gravity of the global economy has shifted away from the transatlantic powers. The best performers in the crisis have been emerging markets. Of course, it is difficult to say whether China still is a developing economy – some suggest it is very developed already. But in any case, China, and its stable demand, has been a very positive factor in the crisis – and so have other rising powers such as India and Brazil.

While there is a near consensus that OECD governments had to provide stimulus packages in order to avoid an economic crash, one of the key questions of the current decade will be the sustainability of government debt. Of course, in Europe we have had to learn that membership

in the eurozone does not stop governments from running imprudent fiscal policies. While European countries have agreed on an emergency scheme for Greece, it is far from certain that Athens will be able to avoid the need for a restructuring of its debt. Greece may not only have to go to the IMF, eventually it might default. But the trouble is not limited to Greece. In the U.S., debt levels are rising quickly – and the population is aging. Most OECD economies are facing a demographic shock – and it appears that policy-makers and society at large rather ignore this issue. Rising public debt and aging populations are a dangerous mix. The United Kingdom is facing a long period of economic adjustment, and some pessimists have already suggested that Britain might default later this decade.

In addition, government intervention has reached a dangerous level. The world's second largest car producer is state-owned, and it is not the Chinese manufacturer Geely. In Germany, those banks that have the largest exposure to Greek government bonds are state-owned. Would Berlin bail out Greece or would it bail out itself in the event of a default?

While we know quite a bit about the origins of the crisis, we have not yet made significant progress in financial regulatory reform. Policy-makers have concentrated on crisis management, and with the first signs of stabilization, the appetite for tough reforms appears to fade away.



Jürgen Chrobog

Or hasn't it? Are observers who suggest a failure of the reform process simply too impatient? In today's conference, we will discuss the current stage of reform and will try to identify those areas where progress is most urgently needed. But there is, of course, the question of international cooperation. While many agree that cooperation is necessary, the odds are not looking in favor of a successful reform project. The U.S. has taken the lead and is closer than other countries with regard to the implementation of a significant reform package, as Senator Frank has pointed out last night. While this is a good development, of course it reduces the chances for broader cooperation. The G-20 in particular might suffer more than expected. The group's rise to prominence was hailed with praise in 2008, but so far the G-20 has failed to deliver, and financial reform is limited to national, rather than global, initiatives. Looking beyond the transatlantic group, the crisis has improved the position of emerging markets in the global economy. More important than actual economic developments might be the change of perception. Are elites in the

South still convinced by the policy recommendations that have been/that are being developed in the North? Or does the South quietly go its own way – intellectually, economically and politically?

We also want to keep an eye on the private sector and its handling of the crisis. Sustainability has become a common term in boardrooms. The BMW Group, for example, is advocating sustainability both in its product range as well as in its industrial relations. Many European companies in particular have refrained from laying off staff in the crisis – which of course is an important dimension of a sustainable corporate strategy.

Let me conclude my introductory remarks by extending my gratitude to our partners SAIS and GARNET for their excellent cooperation in making this event possible. I look forward to continuing our partnership and thus to further enhancing the transatlantic dialogue on economic policy among business, politics and academia in the future.

Session 1

Taking Stock: Where Do We Stand in the Crisis?

Nineteen months after the near collapse of the global financial system, the global financial crisis appears to have been managed surprisingly well. Considering the doomsday predictions in late 2008 and early 2009, there has been a remarkably smooth development. We have neither witnessed a collapse of the global financial regime nor a dramatic rise of protectionism. Yet at what cost? While both the financial sector and producing economies have fared well, governments have shouldered unprecedented levels of responsibility and debt. As governments and central banks debate exit strategies from their emergency measures, the question arises how and when these will materialize. Nineteen months later, it is still unclear how the government can unwind its involvement in large industrial and financial companies and how the next crisis – the debt crisis – will be tackled. Will citizens pay for the crisis by rising inflation or taxes? And what could diverging levels of inflation mean for international economic relations?

The opening remarks were held by **Richard Fisher** (President and Chief Executive Officer

of the Federal Reserve Bank of Dallas), who examined the past year and the actions the Federal Reserve had taken. The liquidity measures that were put into place prevented the economy from collapsing. Just when the system came to a “screaming halt,” the \$1.2 trillion in emergency measures helped to avert the catastrophe. All in all, Fisher concluded that the Federal Reserve “did its job.” He acknowledged that the massive liquidity injected into the market had caused some problems. Initially, there were inflationary pressures, but these were, according to Fisher, stopped. However, one of the negative consequences of the Federal Reserve's emergency measures has been the significant growth of the Bank's balance sheet to a point Fisher finds “way too large.” What is needed is a realistic exit strategy, he said.

For Fisher, more worrisome than inflationary pressures or large balance sheets are, however, the growing fiscal pressures. In the United States, the deficit has grown to about \$1.4 trillion a year. The fiscal expansion pushed through Congress was “completely unsustainable”

and has levied a \$90 trillion liability on future generations.

Fisher assured his audience, though, that the Federal Reserve would not monetize the debt. The role of his institution is to be lender of last resort. Now it is time for the fiscal authorities to take over and balance the books. However, Fisher feared that the “fiscal incompetence” of the U.S. Senate might dim the prospects of the fiscal authorities to get the deficits in order.

Fisher closed by remarking on Greece, whose situation he found troubling but hopeful, since the Greeks realized that they could no longer call on the central bank to bail them out. At this time, “Greeks have to pull up their sleeves and work their way out of the debt crisis.”

The panel's second speaker, **Jürgen Stark** (Member of the Executive Board, European Central Bank) took a broader view at fiscal imbalances and the state of the global economy. According to Stark, the global economic recovery is still uneven. While the economies of Asia are rebounding, growth in Europe and the United States remains gradual. Stark found this unevenness of recovery unsustainable, especially since the growth projections for the EU and U.S. were very low. Stark reminded the audience of the long-term damages of the crisis which might be exacerbated by these low growth rates.

In terms of monetary policy, Stark agreed with his U.S. colleague Fisher that all the central banks had reacted very generously. In terms of GDP, this balance-sheet enlargement is similar

among the Western central banks. In detail, there are, however, differences. The European Central Bank's balance sheet changed primarily by increasing its long-term operations while the Federal Reserve and the Bank of England purchased short-term securities. In the UK, the Bank of England purchased almost everything that was issued by the Treasury, stated Stark. While Stark noted that fixed-rate full-allotment measures will stay in place as long as needed, he also said that these balance sheets were now too large.

According to Stark, the vigorous responses of central banks have “saved us so far.” But this has a price. On the one hand, there is the danger of inflation expectations. The price developments in the EU are feeding these with the EU inflation rate jumping from 0.9 percent to 1.5 percent.

On the other hand, there are more structural dangers. The developed countries in the West will exit the recession with the largest deficits in history. In some countries, such as the U.S. and the UK, the deficit-to-GDP ratio has been growing to extreme levels. Stark predicted that without significant policy change, the debt-to-GDP ratio in Europe will be around 100 percent by 2020. Even with consolidation efforts of about 0.5 percent per year, the debt-to-GDP ratio might still rise beyond 80 percent. Just going back to pre-recession ratios could take more than 20 years, he said.

In terms of budget deficit as percentage of GDP, the picture is equally troubling. In Europe, Ireland is leading with 14 percent, followed by



Richard Fisher
Jürgen Stark

Greece. But the situation in the individual U.S. states is similar, with Arizona and Texas leading the way. Looking ahead, these large fiscal imbalances will crowd out private investment and reduce the governments' abilities to counter future shocks to the economy. While there is an active debate within the EU regarding the short-term negative impacts of consolidation, the long-term benefits of fiscal consolidation are clear. More so, spending cuts is the West's only viable option, stated Stark.

The third speaker of the first session was **Beatrice Weder di Mauro** (Chair of International Macroeconomics, University of Mainz), who warned that “we are not over the hill yet.” For example, the level of intermediate and investment goods of the German economy are still very much lower than before the crisis and lower than the long-term average. Another looming question is how the West will exit the crisis. Will it be a V-, L- or W-shaped recovery? According to Weder di Mauro, Korea and Sweden have returned to pre-crisis growth levels within a few years. But Japan and Thailand have

made different experiences. Decades later, their growth rates are still much lower than they were before the crisis, implying higher costs and greater impact of the crisis.

Weder di Mauro suggested that this crisis would affect the West for a long time. This is exemplified by the growing fiscal imbalances and the fact that 40 percent of global GDP currently reside in countries that have fiscal deficits of 10 percent or more. Before the crisis, this number was around 5 percent. Also, the deficits that have been exacerbated by the crisis will not be lessened by the disappearance of automatic stabilizers. These will not disappear and then reduce the deficit.

According to Weder di Mauro, there are three issues on the table that need to be addressed. Europe and the U.S. are far from having exited the crisis yet. Firstly, the central banks had to pay tremendous amounts of money to fight the crisis. Even if not all the money was used, people are plain wrong when they say that this crisis was not as costly as they thought.



David Wessel

Beatrice Weder di Mauro

Another issue is global financial regulation. For Weder di Mauro, the issue is not too big to fail, but rather too systemic to fail. What the financial system needs is a macroeconomic tool that will work across all institutions. The previous approaches, such as the Basel process targeting banks, are too piecemeal. Instead of focusing on individual institutions, they need to examine the whole picture. A year and a half into the crisis, the world still has not been able to produce an agreement on sharing information on risk, such as a risk map.

Cross-border cooperation was not working either. The crisis clearly emerged from cross-border issues. What thus is needed are global institutions to deal with these global issues. For Weder di Mauro, the currently discussed national approaches, such as a bank tax in Germany, cannot be the answer. These efforts need to be discussed and executed on the international or at least European level.

Lastly, there is a missing fiscal architecture in Europe. The percentage of EU countries not

fulfilling the criteria of the Euro zone is “terrible.” Currently, there is not one country in Europe that does not violate at least one of the criteria of the EU Stability and Growth Pact. Just as Chancellor Merkel said, Europe cannot stop just because it is difficult.

David Wessel (Economics Editor, The Wall Street Journal) finished the first panel’s presentation part by taking a look at how this financial crisis might affect societies on both sides of the Atlantic. In the U.S., the crisis had led to a steady erosion of confidence in the government and its institutions. Wessel quoted a recent Gallup poll that ranked the Federal Reserve lowest in approval ratings – even lower than the IRS. According to Wessel, politicians cannot regain this confidence by telling people that “it could have been worse.” The fact that the Federal Reserve saved the economy from a complete meltdown may be true but does not help politicians running for re-election.

Wessel credited the role of Europe’s built-in automatic stabilizers in the recession’s

aftermath. While the United States has lost 8 million jobs and needs to create about 2 million additional jobs just to absorb new entrants into the labor market, Europe’s systematic approach to lessen the economic blows has reduced the initial impact. Germany’s Kurzarbeit (short-time work), for example, helped to reduce the employment losses, resulting in that country currently having a lower unemployment rate than the U.S.

However, on the question who will do a better job exiting the crisis, the jury is still out. Germany is better at creating jobs in old economy industries such as the car manufacturer Opel, but Wessel saw U.S. job growth in companies like Google. All this, to him, is an indication of the flexibility of the U.S. labor market.

Even though the Anglo-Saxon model is clearly on the downswing, Wessel cautioned against the United States’ economy becoming more like that of France or Germany. The role of the government has been permanently expanded and while the government will not own companies like GM forever, people today have a lot less faith in former creeds like “just leave it to the market.”

Secondly, Wessel feared the impact of the recession on the behavior of Americans. Now, Americans are spending less and saving more. But in the long run, they might have lost more than their appetite for consumption. Wessel also worried that this recession and its ramifications might lead to a loss of appetite for risk – “the good risk.” That, according to Wessel, would be terrible.

Another behavioral change brought on by the recession resulted from the expansion of the federal government’s role. With this expansion, Americans increasingly demand more from their government. At the same time, Americans are less willing to pay for the services they demand. According to Wessel, this combination of lack of trust and heightened expectations highlights a disconnect that will make fiscal reforms even harder to accomplish.

Discussion Session 1

The discussion was opened by **Thomas Mayer** (Chief Economist, Deutsche Bank Group), who interjected that any hopeful news from Greece that Mr. Fisher alluded to must be contrasted with the country's increasing risk of sovereign default. Mayer asked how to prepare for sovereign defaults and its consequences. He also said that he worried about inflationary pressures in emerging markets, such as China, which he feared could be monetizing U.S. debt. Fiscally speaking, the U.S., according to Mayer, needs a plan similar to the German debt ceiling, the *Schuldenbremse*.

Otmar Issing (President, Center for Financial Studies, University of Frankfurt) disagreed with the characterization that Europe is the weak element in the global recovery. According to Issing, the U.S., for example, has not even begun to address the issue of how to solve its fiscal problems. Without that, it is difficult to say who will exit the crisis in better way.

Another panelist who disagreed with Fisher's "good news from Greece" statement was

Jacob Funk Kirkegaard (Senior Research Fellow, Peterson Institute for International Economics). Greece still is faced with a massive solvency issue, he said. If this continued, the transfer of liability from private to public sector would pose a serious risk to the country and significantly involve the European Central Bank.

Nikolaus Piper (New York Correspondent, *Süddeutsche Zeitung*) raised a question about inflation. A recent paper by the IMF's Olivier Blanchard stated that a little inflation was not too bad. Now David Wessel asked leaders not to be too austere. Piper was interested in hearing the panel's position on this issue.

Heribert Dieter (Senior Fellow, German Institute for International and Security Affairs) reminded the panel of the fact that the government let Lehman Brothers default. He asked if, in hindsight, this was a fundamental mistake or if it was good to let banks go broke. Given the problems in the eurozone, Dieter also wondered whether the sovereign risk has not been sufficiently communicated to euro countries.

Amar Bhattacharya (Director, G-24 Intergovernmental Group of Twenty-Four) wondered about the geographical nature of fiscal problems. While the advanced economies are currently struggling with these issues, the emerging markets do not have a legacy of excess. India, for example, already has debt regulation laws. Do these problems touch upon the role of the IMF?

Paola Subacchi (Research Director, International Economics, Chatham House) asked about the role of the EU in this crisis. According to Subacchi, the imbalances within Europe are significant. Maybe the EU needs to address one of its core issues – the lack of a political union. Lastly, Subacchi asked what the impact of deleveraging the private sector will be on the member states' process of fiscal consolidation.

Greece was also at the center of the question posed by **Randall Henning** (Visiting Fellow, Peterson Institute for International Economics). The EU-IMF program might hold off the country's problems for a year. But beyond that, the collateral policy of the ECB will come up again. How much risk does the ECB want to take on? What is its strategy?

In his reply to the comments, **Richard Fisher** reiterated that there were limits to what central banks could do. At this point, it is the political class that needs to react. The Federal Reserve cannot monetize the debt. Arguing for inflation only leads down a slippery slope. As long as the central bank's independence is safeguarded, it can do what is unpopular.

Regarding China monetizing American debt, Fisher did not think this was an issue. Rather, the U.S. need to worry about China not buying treasury bills. According to Fisher, China is now a player in the game and fully involved in global capital markets. Fisher argued that the economic system was at an inflection point. He foresaw a permanently enlarged government and a future generation of citizens with less faith in the government's ability to protect their health, social security, et cetera. This would lead to higher savings rates. Fisher agreed that small businesses would not have the ability to react to the crisis; what is holding them back is fear of the future and of over-regulation.

Jürgen Stark commented that the situation was much worse in the U.S., Japan, and the UK than in the EU area and dismissed the idea of a European Monetary Fund. In the U.S., for example, the state also did not step in to save California. For Stark, it is time for the individual states – be they Greece or California – to straighten out their issues.

In terms of getting out of the fiscal situation, Stark advised looking at Ireland, which took bold decisions based on political consensus. Now, the country is going ahead with an austerity plan outlined for several years. The same rationale must be applied to Greece: Greek problems will not be solved in Brussels, Frankfurt, or Washington, D.C. They can only be solved in Athens.

Generally speaking, the debt issue will have a long-lasting and permanent impact. Countries



Daniel Hamilton

will not be able to grow out of deficits by huge GDP gains. At the same time, the central banks will not monetize the debt and tax raises are politically unpopular. For Stark, the only way out is to cut expenditures.

One of the issues in Europe is that the Stability and Growth Pact was weakened in 2005. There is little the ECB can do about that and it will not change its policy because of one country. In terms of monetary policy, Stark found the interest rates “appropriate,” while the called-for exit strategy was already implemented within the ECB.

Beatrice Weder di Mauro explained that the German debt ceiling approach was also problematic since there was a strong reluctance in the German states to act upon this.

According to Weder di Mauro, the institutions of the European Stability and Growth Pact work to a certain extent. What is needed now is an orderly restructuring of debt. Looking ahead, Weder di Mauro stated that fees in times of

crisis only made deficits worse; rather, countries need to be forced to give up sovereignty. She also called for an automatic tax or fee which automatically sets away funds for times of crisis.

David Wessel saw more systemic failures in the run-up to the crisis. The system was not set up for something like this. In the short term, economic growth within the EU is not going to contribute to the solution. To Wessel, the question ahead is whether the FED and ECB would reach their inflation targets and not under-inflate in the short term. No one, said Wessel, knows the inflation rates of individual states in U.S., while people know the inflation rate of Germany.

As for a missing monetary fund in the U.S., Wessel noted that 20 percent of the U.S. Recovery Act went to individual states. The GM bailout, for example, thus functioned in a similar way as a monetary fund’s measures, with tax payers in New York supporting Michigan’s economy.

Session 2

Prospects for Financial Regulatory Reform

The second session called “Prospects for Financial Regulatory Reform” examined the feasibility of more structured mechanisms for cross-border collaboration. Recently, several national governments have pushed forward with suggestions for financial reform. Yet national efforts on financial regulatory reform are unlikely to be successful without more effective international collaboration. How should such collaboration be structured? What issues deserve priority attention?

Roger Leeds (Research Professor of International Finance, Paul H. Nitze School of Advanced International Studies) started this session with an overview of the complexity of the issue. According to Leeds, regulating the financial sector is a far greater challenge than regulating the private sector. The financial sector is like globalization in a nutshell. It employs a far more diverse international workforce than other industries. Additionally, no other industry can do transactions in an easier and cheaper way.

According to Leeds, any planned financial reform needs to distinguish between laws, regulations, and collaboration. Barring a truly global agreement, regulating this fast-changing and complex industry is close to impossible since there is too high a risk of leakage, too much regulatory lag and there will always be regulatory arbitrage. Finally, regulation would also collide with national interests. While, for example, Germany’s main interest is the protection of its Mittelstand (SME sector), France emphasizes its National Champions. These conflicting interests will prevent regulation.

On other hand, Leeds was convinced that global collaboration could be improved, citing the Basel bank reforms as a good example where the world came together successfully. Another example was the spontaneous collaboration after the global financial crisis. While it was not as structured as it could have been, it in the end still worked, Leeds said.

Otmar Issing agreed that in international capital markets, regulation or any attempt



Roger Leeds
Otmar Issing



David Altig
Mark Taylor

to regulate was extremely difficult. But that does not exclude setting rules which the financial sector is in dire need of. Financial industry markets need to have certainty for the future. While the cyclical problems had improved, the structural issues now need to be taken care of, because: “This must not happen again.” The comparisons to the financial crisis of 1929 were too stark. The hubris before that crisis was similar to the thinking that the current crisis could not repeat itself.

Issing stated that it was important to start from this notion. The causes that led the world into the crisis were factors on the macro- and micro-level, such as low interest rates and lacking regulation in housing markets. According to Issing, the combination of too little capital and too much leverage is particularly dangerous and has not been properly addressed yet. Heads of state and governments realized this problem when they came together and talked about these issues in late 2008 in Washington, D.C. With this in mind, it is time to examine the remaining challenges.

Creating a new system, however, might lead to more loopholes than already exist today. What is needed are global rules, an agreement on accounting standards, compensation – not just on the national level, but internationally – and global data collection and exchange. Right now, it is still unclear where all the risks are concentrated. Here, Issing called for more initiatives.

Issing closed by stating that the issues at stake were beyond too big to fail or too connected to fail. Free market societies are based on the idea of taking risks. While there are rewards for good ideas, losers will also have to swallow their losses. But this system will only work if information, supervision, and cooperation are improved.

David Altig (Senior Vice President and Director of Research, Federal Reserve Bank of Atlanta) compared global economic prosperity and financial regulation to the efforts of a gardener and a mechanic. While the gardener prepares the soil and sees to it that the economy is growing, the mechanic needs to repair the economy once it has broken down. Along the same lines,

monetary policy makers need to be like gardeners, taking care of the overall economic situation. But the “gardening” could not be employed at length once the system was damaged.

At the same time, one cannot ask the regulator – the mechanic in Altig’s example – to repair the economic machine before it has broken down. Financial regulation can always only be done ex-post. According to Altig, once policy-makers realize that no regulation will ever be able to eliminate all financial risks, one can start to improve the mechanic’s toolbox and come up with better ways to repair damages to the economy after a crisis.

If policy-makers, for example, limit the size of certain institutions for the sake of regulation, those regulations will then help shift activities from highly regulated institutions to those that are lightly regulated. Even this well-intentioned regulatory stance, aimed at maintaining the integrity of bank capital cushions, inadvertently would push what would become an even bigger problem in the direction of a less regulated firm.

In Altig’s view, closer scrutiny of financial institutions and well-thought-out rules governing capital, leverage and so on are not without value. Suggestions like the “Volcker rule,” derivative exchanges and trading restrictions, are not necessarily bad ideas. But even with seemingly great safeguards in place, failure of some systemically important institution will ultimately occur – somewhere, somehow. Consequently, priority has to be given to the development of resolution procedures for institutions that are otherwise too big to fail.

Altig closed by stating that the best thing to do now was to examine the case studies of Lehman Brothers, AIG, and Bear Stearns. These cases would then allow policy-makers to test whether their proposed measures would have had any impact on the decline of these companies and how to repair the damage in a quick and economical way the next time a crisis ensued.



Mark Taylor (Professor for International Finance and Macroeconomics, University of Warwick) summarized the findings of the Warwick Commission on International Financial Reform.

The main recommendations are to rein in banks and financial institutions in order to avoid fuelling asset market bubbles even in times of economic and financial boom. Secondly, financial regulators need to curtail institutions' ability to heighten risk by mismatching the maturity of their assets. Thirdly, regulators need the flexibility to apply tight regulatory requirements on institutions that threaten the stability of the whole financial system. The commission also called for increased powers for national regulators in a bid to prevent banks from establish-

ing overseas branches and regulating them from their home base. Lastly, the process of host regulation would lead to a "right-sizing" of the financial sector, so that the finance industry would not be allowed to excessively dominate a country's economy.

In summary, Taylor said that these measures were necessary to prevent the next financial crisis. Even more, economists needed to keep in mind that what was good for the individual was not always good for society.

Discussion Session 2

Beatrice Weder di Mauro wanted to know what the panelists actually meant by collaboration. Was the Basel experience (Basel I and II) really productive? Weder di Mauro was not so sure. Furthermore, the cross-border issues are not easily resolved by such international agreements.

Hans Reich (Chairman of the Supervisory Board, Citigroup Global Markets Deutschland) stated that different solutions were needed for different countries and markets-related issues.

Nicolas Veron (Visiting Fellow, Peterson Institute for International Economics) had a question about what could realistically be achieved in terms of financially reforming the G-20 and the IMF.

Jacob Funk Kirkegaard asked whether incentives matter and whether countries' willingness to accept income inequality would make global agreement possible.

Roger Leeds stated that it was currently more important to agree what should happen instead of what might happen if actions will not take place.

Mark Taylor asked about the degrees of regulation in the proposals. Financial hubs like the city of London would be hit hard by strong regulation. What is needed instead, he said, is a re-examination of financial incentives that work.

Roger Leeds concluded the discussion by stating that this session had raised more questions than answers.

Session 3

Towards a New Global Economic Governance – What Role for the G-20?

Session three dealt with the future of global governing institutions such as the G-20. Before the crisis ensued, little progress had been made in the realm of international economic governance. Institutions such as the G-8 seemed to be unable to manage the incredibly complex issues of global financial stewardship while older institutions, in particular the International Monetary Fund, lacked support, and potential customers tried to avoid using the IMF's services. The crisis has led to a renewed interest in the potential of global economic governance, particularly of the G-20. The question arises, though, how the G-20 can meaningfully contribute to the management of the global economy. Does it have the legitimacy, and are its member countries willing to shed sovereignty in order to avoid major turbulence in the global economy?

Heribert Dieter opened this session with a general question about the usefulness of the G-20. According to Dieter, it has failed so far to deliver a set of solutions to solve the problems. While it succeeded in fighting the crisis,

it has until now not added any concrete suggestions for reforming the global financial architecture. Instead, member states have embarked on national regulation. Dieter called on the G-20 to rather focus on identifying global imbalances and answering questions such as whether capital flows played a substantial role in the current crisis and if both surplus and deficit countries were ready for change.

Dieter mentioned that the current account balances had tripled since the 1997. While deficit countries import capital to finance their spending binges, countries like Russia and Saudi Arabia are enjoying a boom in selling their resources. Germany, on the other hand, did not think about the disadvantages of its current account surplus. Dieter cited German economist Hans-Werner Sinn who had stated that Germany had exported Porsches and received Lehman Brothers derivatives in exchange.

According to Dieter, it is now time to look ahead. In the United States, however, there is a tendency to blame others, such as China,



Heribert Dieter
Johannes F. Linn

for the problems the country is in. This is especially problematic since recent developments in China, such as investments growing 40 percent compared to before the crisis, suggest that exports from China will not decline any time soon. Rather than asking or hoping for change abroad, Dieter challenged the U.S. to start changing its own patterns of saving and consumption and make its companies more competitive.

Dieter concluded with a worrisome outlook for the developed world. With neither big surplus countries nor deficit countries willing to change, the next conflict might be trade. Unlike the trade war with Japan in 1980s, this time the U.S. would have to deal with undemocratic countries, such as China, which could damage the liberal trade regime. The only solution is restricting capital flows, said Dieter.

Johannes F. Linn (Director, Wolfensohn Center for Development, Brookings Institution) argued that there already had been significant agreements at the G-20 level that pointed in

the right direction. Comparing the G-20 with the G-8 highlights the progress already made and should be the measure of success.

However, four challenges remain. The G-20 needs to show progress in the legacy areas of multilateral surveillance, financial regulation, protectionism, and the reform of international financial institutions such as the IMF and the World Bank.

On the World Bank side, very little has happened so far. The IMF has debated chairs and shares, but changes have been gradual and not enough. These institutions remain too transatlantic and not global enough for their needed legitimacy. Additionally, the Europeans cannot push for further seats in these institutions. Linn found this unrealistic and not constructive. If anything, the Europeans should reduce their influence in these institutions. Here, Linn foresaw a stalemate between different European governments. Linn also called for an institutionalization of the G-20. The Koreans had already outlined this in their plans



Thomas Mayer
Richard Higgott

for the next summit. In Linn's view, the G-20 needs a staff council for logistical efforts and generally has to become more formalized.

Lastly, Linn suggested that the G-20 should have a discussion about its mandate. With the G-8 basically dissolved after the Canada summit this summer, the G-20 needs a mandate outlining true global leadership. Rather than dealing with financial issues only, it needs to expand the development structure. This should happen not through aid, but, for example, through a program for global sustainable development – something the Koreans had again been eager to put on the agenda. On the finance side, Linn foresaw a change in the quantity and quality of assistance. The new G-20 needs to move away from the donor perspective and also make use of the resources of China and India. In Linn's view, these measures would increase the G-20's legitimacy.

The third speaker was **Thomas Mayer**, who presented his research model on the impact of budget deficits on the developed and devel-

oping world. In general, there are lower growth trends worldwide. Using middle-of-the-road assumptions about interest rates and growth, and with no major changes in financial monetary policy, the debt ratio of developed countries will on average rise to 130 percent by 2020. While in the late 1990s the debt levels of developed and developing countries were still relatively similar, by 2020 the developing countries' debt will rise to only 40 percent of GDP. The UK, Ireland, Japan, and the U.S. are not the only countries with serious debt problems. Apart from the Scandinavian countries and Australia, no Western country was doing well. By comparison, the developing countries are better off.

When adding negative shocks to the system, such as changing interest rates, the situation looks even worse for the West. The debt-to-GDP ratio in the developed world could then rise to 150 percent, while these shocks would only have a marginal effect on the developing countries by raising the ratio to about 50 percent of GDP.



Mayer outlined that even with consistent budget surpluses of 0.5 percent in the UK and 2.5 percent in Greece, these countries will succeed to stabilize their debt stock only in 2020. To lower the debt level to 80 percent, Greece would need to run an 8-percent budget surplus

for the next decade. A combination of lower growth, higher debt, and higher risk premiums would occur in developed countries and lead to a relative rise of the developing world.

Discussion Session 3

T.J. Pempel (Professor of Political Science, University of California, Berkeley) asked about the political demands that developing countries would make of the developed countries. Now that lending countries have power – will their demands grow? Can the bargain as we know it continue as it is?

Amar Bhattacharya stated that the growth was going South, while the debt went North. Between 1970 and 1990, the economic share of the developing world had been declining. After stabilizing in the 1990s, it now is growing again. Between 2005 and 2014, the share would increase by 10 percentage points. And this growth includes all developing countries, not just China. Even more, Bhattacharya found this to be happening with unprecedented pace and magnitude.

Bhattacharya also saw a number of positive outcomes of the G-20's reaction to the crisis. Firstly, it led to the largest and most coordinated global financial stimulus in history. Secondly, it established a blueprint for financial reform.

And lastly, it allotted financial resources worth a trillion dollar to financial institutions.

Bhattacharya also remarked that the G-20 had better accountability than the G-8 and that the G-20 was far more inclusive than other international organizations, such as the World Bank.

The challenges that remain include the fact that the G-20 is a self-selected body. It needs to pay attention to membership and also leverage other groups, such as the African Union. That will allow an inclusion of others without extending membership to these organizations. Lastly, Bhattacharya noted that international financial reform had not been tackled yet but that the G-20 at least provided an inclusive framework to discuss these issues.

Bhattacharya closed by stating that the strengths of the G-20 were under-recognized outside of the organization. In his view, what the G-20 needs is to improve its outreach. The question for Bhattacharya was rather if its successes would continue once the crisis was over.

Inge Kaul (Adjunct Professor, Hertie School of Governance, Berlin) was fond of the G-20, but feared that an expanded agenda would weaken the organization in the end. The baseline for any internationally successful organization was like-mindedness. In an ever-expanding G-20, how could one manage expectations? Kaul also asked if people in the developing countries would also not demand more services once their wealth grew.

Paola Subacchi asked whether the entire model of economic growth might need to be re-evaluated. While economic growth was still occurring in the West, many of its economies seem to have lost their ability to adapt.

Shigeo Katsu (Special Advisor to the Managing Directors and Former Vice President Europe and Central Asia, The World Bank) asked about the role of global institutions compared to regional organizations and whether there was a serious risk of a market bubble.

Thomas Mayer responded to the question about whether political demands in the developing world would rise in parallel with the wealth of these nations. A shift in economic power would also lead to political requests. Clearly, the developing world would raise questions about the number of European representatives in organizations like the G-20 or the IMF.

In terms of the growing demands in developing countries causing more public spending, Mayer argued that even if this was the case, the relation between the developing and developed nations' debt-to-GDP ratio would still be staggering.

Heribert Dieter also replied to the statements on the G-20. He said that as long as the G-20 lacked a mechanism to explain how to get out of the current crisis, it would not work. He also said that the BRIC countries could not ask for more representation in institutions such as the World Bank, the IMF, and the G-20 and then go on meeting within their own group.

Richard Higgott (Pro-Vice-Chancellor for Research, University of Warwick) commented on the issues of like-mindedness and G-20 reform. At this point, the West should collaborate with the Koreans to influence the agenda of the next meeting. That is how the West could contribute to a balanced growth agenda.

For Higgott, like-mindedness cannot be the ultimate goal. There are too many conflicting stances within the global community. Additionally, without members such as China and India, the global community could not have solved the financial crisis in 2008, Higgott said.

Sessions 4

North America and the EU in a G-20 World



Daniel Price
T.J. Pempel

Among the main victims of the global financial crisis were the OECD countries. Not only did their economies experience the strongest decline, but, more importantly, the Western economic strategies also lost credibility. As the world is slowly exiting the crisis, it is time to ask how much influence over the developing world North America and the EU still possess. Is there a danger of the emerging countries emancipating themselves economically and intellectually from the old transatlantic world? And will these countries organize themselves and cooperate outside the existing structures of economic governance?

Starting the session, **Richard Higgott** argued that the emerging countries were emancipating themselves from the transatlantic structure. Higgott stated the key assumptions that drove European policy: first, the world is moving towards multipolarity; second, the EU will be one of the major poles; and third, the transatlantic relationship will be the key driver of the multipolar world.

While he found concepts like the “BRIC” countries overrated, Higgott did see a move towards bloc building or regiopolarity occurring. On issues like climate change, China was not a part of the BRIC, but sided with other, less central or powerful actors. In the diplomatic field, the lacking collaboration between the BRICs support this theory.

But according to Higgott, the regiopolarity would also lead to a fragmentation of authority and thus to the rise of new actors. The transition to a new, inherently more instable world order would especially affect the transatlantic relations, said Higgott.

What was needed for the transatlantic actors was an integrated strategy – little steps such as the Lisbon Treaty, for example. But absent a larger strategy, these steps would only count for little. Additionally, the West is still dealing with a 20th-century understanding of global cooperation. Higgott cited as an example the large presence of European representatives in international organizations. Instead of these

countries leading in the interest of Europe, they continue to act only in their own self-interest. According to Higgott, the EU also has problems acting multilaterally, as the outcome of the Copenhagen Climate Conference highlighted, where the EU’s actions hardly met its aspirations.

On the future of U.S.-EU cooperation in foreign policy issues, Higgott warned that the two did not see eye to eye. The EU’s paradigms of interdependence and risk aversion clash with the U.S.’ globalist and pragmatic stance. While the U.S. values partnership, it does not see it as strategic. The U.S. has an instrumental, not a sentimental understanding of partnership, concluded Higgott.

As a participant and organizer of the first G-20 meeting, **Daniel Price** (Senior Partner for Global Issues, Sidley Austin LLP) noted that an EU position was completely absent in the G-20 negotiations. The positions that emerged were not a result of EU deliberations. While Germany pushed against deregulation, France

wanted to close tax havens. In the end, the decisions were made by the U.S. and the principle member states of the EU, not by North America and the EU.

Additionally, Price noted that in the run-up to the G-20 meeting and beyond, the interests of European countries had been largely defensive. President Bush’s idea to elevate the finance ministers’ meeting into a broad international meeting had not been welcomed. A number of European leaders opposed this and only wanted a G-8-plus-5 model. Europe was also not comfortable with the inception of the Major Economies Forum.

Price accepted that the G-20 was not an ideal group, but asked the conference not to make perfect the enemy of the good. The best use of the G-20 is to provide political impetus, he said. Price acknowledged that there was room for transatlantic leadership. He considered this essential so that recommendations would be faithfully implemented.

Without transatlantic cooperation, there would be no way the world could get issues like financial regulation right. Both sides of the Atlantic need to lead by example and occasionally subordinate their national interest to the greater good. According to Price, this is also true for trade, about which the current U.S. administration has been ambivalent.

The third panelist, **T.J. Pempel**, reminded the conference that while the transatlantic relationship still played a dominant role in today's world, the resurgence of Asia was, in the long run, a natural development. Until as late as the 1750s, China had contributed close to 40 percent of global GDP. A similar story could be told about India. Even more, these countries had always heavily relied on export-led growth. China, India, Japan, Indonesia, and South Korea would all be soon among the world's ten largest economies, said Pempel. In the West, the Asian financial crisis of 1997-98 was seen as a vindication of Western-style capitalism. But in Asia, it was seen differently. Most Koreans call the crisis of 1997-98 the "IMF crisis," since the liquidity provided by the IMF had been perceived as insufficient.

In Asia, the current crisis only reinforced the conviction that Asians had been doing it right. The firewall against unwanted financial transactions that was erected after 1998 led to South Korea, Japan, and China amassing 25 percent of global foreign reserves. Asia also reacted by signing many bilateral and minilateral trade agreements across the continent. The perception that the IMF was useless and the Doha Round did not move led to the continent's

major players taking trade measures into their own hands.

According to Pempel, the result of these measures is not a fortress Asia, but greater regional integration and a new model of financial policy. Today Asia is in a position to crow about its strength. Most countries have bounced back pretty well. Additionally, Japan has moved away from the Koizumi-era open economy policy towards social cohesion policy.

These developments led Pempel to conclude that Asia will collectively play a larger role in institutions formerly dominated by the transatlantic relationship. Europe therefore needs to understand the United States' consideration of the rising powers of Asia. In case of a global emergency, President Obama is more likely to call Chinese President Hu than EU President Herman Van Rompuy, Pempel said.

Discussion Session 4

Heribert Dieter opened the discussion by wondering whether the financial crisis was the cause of the non-conclusion of the Doha Round.

Dan Hamilton (Richard von Weizsäcker Professor and Director, Center for Transatlantic Relations, Paul H. Nitze School of Advanced International Studies, Johns Hopkins University) questioned the either-or options presented. Hamilton doubted that the rise of one country would necessarily lead to the demise of another. On the contrary, the rise of the South means that more people would be participating in the global economy. The global economy does not need to be a zero-sum enterprise, since 6 billion people mean countless opportunities for the economies of the West.

In terms of the slow growth predicted for the West, Hamilton calculated that a slow growth rate of one percent in the years ahead in the eurozone was equal to the total GDP of a country like Argentina. This was a still sizeable growth in wealth, he said.

Additionally, Hamilton reminded the panelists that "Made in China" did not necessarily mean "made by China." Even more, comparing investment flows after the crisis, things did not look too bad either. U.S. investments in Europe have dropped 44 percent compared to 185 percent in China. While companies are still investing about 82 billion in Europe, U.S. companies are actually disinvesting in China.

According to Hamilton, now is the time for Europe to position itself in a G-20 world. The question is whether it wants to invest in like-mindedness or disputes over the hygienic treatment of chicken parts. The stronger the link between the EU and the U.S., the more others will want to participate. But if we weaken the connection, others will try to weaken it even more. Lastly, the economic growth model of 6 billion people overusing energy and resources is not sustainable. The economy of the future will be breaking the link between growth and resource use.

Jacob Funk Kirkegaard stated that the Lisbon Treaty had not equipped Europe with all the tools it needed. According to Kirkegaard, President Van Rompuy is a good chairman, not a leader. The European Parliament has also been made more powerful. Kirkegaard wondered if this was beneficial, since previously, the Commission was the power player.

Pierre Pettigrew (Executive Advisor, International, Deloitte & Touche) noted that the recent crisis had helped to elevate Canada's prestige. For example, people now realize that Canadian Prime Minister Martin suggested the use of the G-20 years before the crisis struck. Pettigrew asked why it took a crisis to realize the G-20.

Johannes Linn agreed with Dan Hamilton that the global economy was not a zero-sum game. But looking at the chairs and shares of the international institutions, this might in fact be the case. European countries would have to give up both, which ultimately would make the institutions more effective.

Linn also commented on the growing relations between the EU and Asia. For Europe, Central Asia is far more than a bridgehead to China. The United States should not feel threatened about this process, he said.

Bernhard Welschke (Representative, German Industry and Trade) asked what could be done to enhance a common interest. There are little trade and investment hurdles between the EU and the U.S.; its trade and investment bonds are strong. What is needed now is a deeper

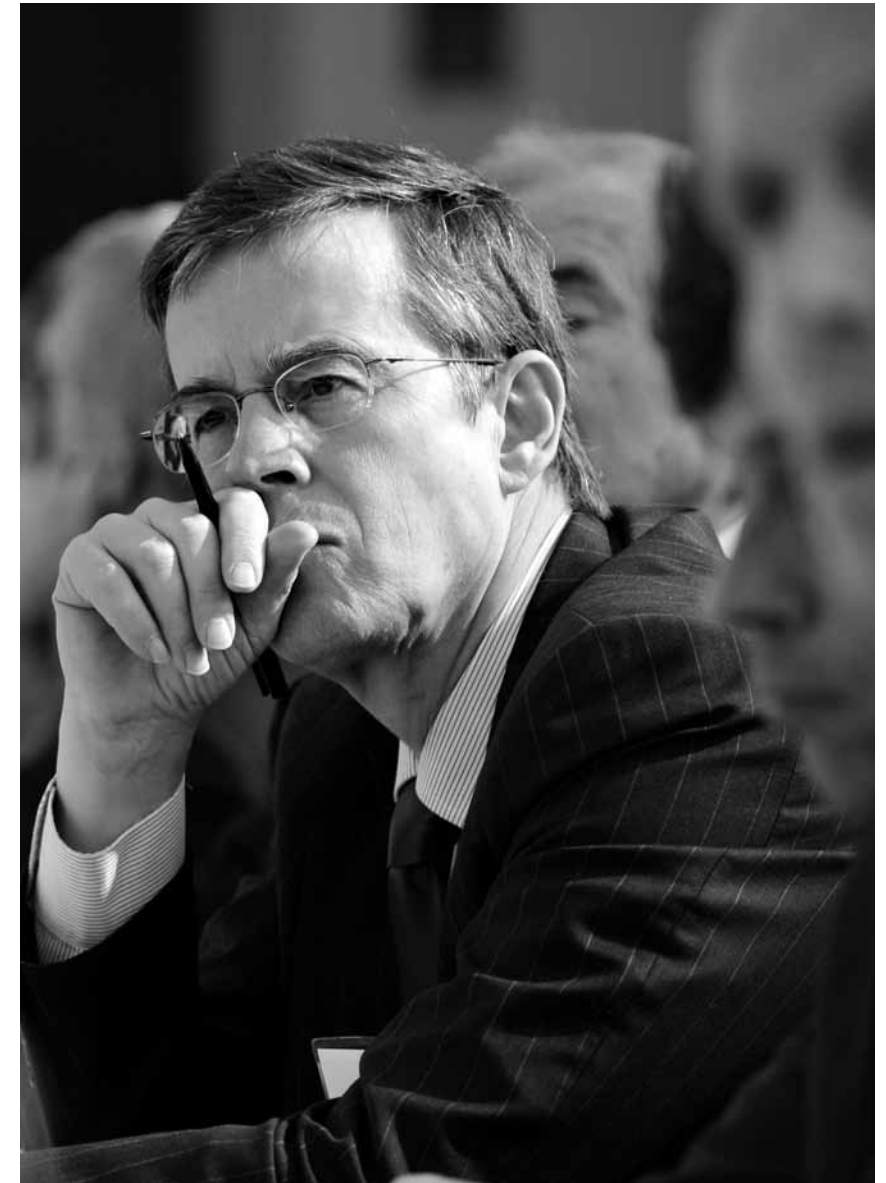
dialogue which would take the partner into consideration. Rather than ganging up against China, both partners should help the country to develop and build a more transparent political system.

T.J. Pempel answered that it was not about either-or, but rather a "transatlantic plus." The more the world becomes middle class economically speaking, the better off were all of the world's citizens.

Daniel Price answered that the different regulation styles proposed by the three leaders' summit were dismal. The UK, the U.S. and continental Europe all had different rules that looked like protectionism. This was not bringing the EU and U.S. together.

On the topic of G-8 versus G-20, Price noted that the Washington G-20 declaration could never have been negotiated without a crisis. Unfortunately, this coalescing around a common agenda only worked in times of crisis. Over the last six years, the G-8 had evolved into an organization dealing with development. Essentially, it had become a group of check writers for the developing world. The G-20, however, was completely different. So in the field of development, the G-8 remains a vital player.

Richard Higgott commented on the remarks regarding the EU and Asia. The reason for creating organizations like APEC was to get Europe to close the Uruguay trade round. Since the Asian financial crisis, institutionalization of this organization had moved forward.



According to Higgott, the allure of U.S. soft power has clearly taken a beating. Now, alternative systems such as authoritarian capitalism are becoming more attractive. The danger for North America and Europe is that large democracies in the developing

world might not line up with the U.S. in the future, concluded Higgott.

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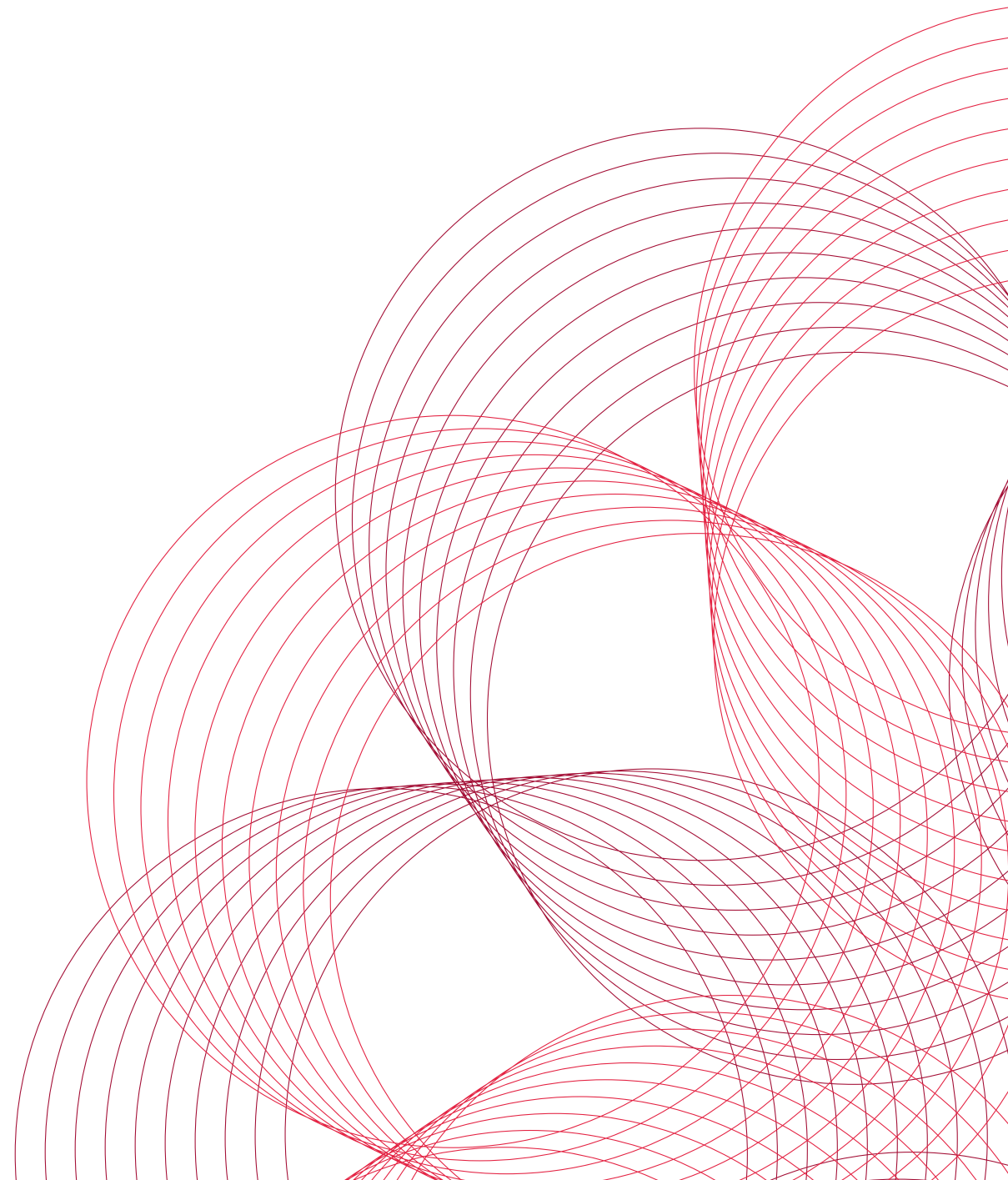
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