IGE/Samsung Electronics Global Business Forum, September 14, 2012
Speaker: Charles Dallara, Managing Director, Institute of International Finance

[Lecture]

It is a real pleasure to be back in Seoul. I am honored again with the opportunity to share with you some thoughts at this IGE and Samsung Electronics Global Business Forum. I've been privileged not only to have had a long time friendship with SaKong but also to have worked with him during his years in the government recently as he played a key role in this outgoing government. But also, years ago, as he mentioned, when I was in the Treasury, he served as finance minister and we worked together on a variety of issues including Korea's exchange rate.

Obviously, this is a special country for me for many reasons, not the least of which is that my daughter was born here in 1984. I recall that during one of my rather difficult set of discussions with Dr. SaKong, he concluded the discussions by presenting a small bag of gifts for my daughter and that made it very easy for me to go home with warm feelings about Korea, which have never changed.

Of course, we live in a very challenging world today, and I can recall visiting Korea just some five years ago right on the eve of the Lehman Brothers' decision. This time of the year people in the US tend to remember 911 for good reasons because it was a traumatic moment for the world. But mid-September I also tend to remember the collapse of Lehman Brothers which I think we're still suffering from. I think it was one of the most misguided decisions in modern financial history to allow Lehman to go under. And I'm afraid that at the moment in global finance were we faced a situation similar to that again today, policy makers might as well find it difficult to step in and stabilize a global financial institution. Perhaps, they may find it difficult to do what they should do because of all of the constraints that have been developed around the governmental support from banks to institutions. It's an interesting and important question to think about because here we stand today five years after the onset of the crisis, four years after the collapse of Lehman and we're still struggling to achieve global economic recovery. There are a lot of reasons for that, of course. And there is a lot being done to try to deal with the weakness in the global economy.

Recently, we've seen rather impressive actions, in the last day, in the last hours, actions about the Federal Reserve launching a new round of quantitative easing, non-traditional monetary policy to support the US economy. Last week, we saw a potentially significant action by the European Central Bank where they have outlined what could also be quite an aggressive program of liquidity support for struggling governments in Europe. Of course, there is a big difference, a huge difference which I don't think markets might be fully appreciating because markets have reacted very bullishly to both of these measures. But if you look at the fine print in the ECB's announcements, you realize that they may have announced the construction and the launching of a battleship. But they said that before they bring it to the battlefront, a whole range of other actions need to be taken. So, for the time being, market participants and all of us will have to watch that financial battleship sit on the sidelines, circling, waiting for the governments of Europe to get their act together.

It may be its worth spending a few moments today, concentrating on the European sovereign debt crisis for two reasons, fundamentally because I think it is at the heart of today's global economic weakness. You feel this in Korea. I'm going over the weekend to spend some days with friends and collaborators in China. They feel it in China. Just talking with friends from Brazil, they feel it in Brazil. Certainly, investors and consumers in America feel the clouds of uncertainty that hang over them due to the irresolution of the European sovereign debt crisis. Obviously, since I've only been here for less than 24 hours now, so I am by no means fully current on your situation, but one has the feeling that the sluggishness in the Korean economy is very clearly related to the sluggishness in Europe. Yes, primarily through the Chinese connection, but still very clearly related and I know it must be a big source of concern here. Certainly, when I talked to not just bankers and financial leaders but businessmen in the United States, they stressed the difficulty of expanding capital investment in a world characterized by such uncertainty. I think we should therefore realize how pivotal a resolution of European problems will be for the global outlook, notwithstanding the fact that many other countries including my own, the US, and your neighbors, China and Japan, have a lot to say about the global economy.

I also will share some thoughts about Europe because I spent so much time there in the last two years. I feel like I've moved there. At the end of one of the rounds of negotiations, Chancellor Merkel of Germany said to me, "Well, Mr. Dallara, we haven't always agreed but I think on the whole you've done an excellent job representing the interest of the financial community and showing concern about the future of Europe and perhaps, we should therefore award you an honorary European citizenship." And she turned to her staff and said, "Can we do that?" and her staff said, "Well, Madame Chancellor, there is no such thing as an honorary European citizenship." I said to her rather sheepishly, "Maybe because there is no such thing as a European citizen." But in truth that's the reality. So much of the story of Europe today can be told through the prism of the tensions between national concerns, parochial perspectives and nationally elected leaders trying to stabilize their own backyard trying to deal with their own political futures, while still trying to forge progress toward this grand vision of Europe. And there is a dramatic tension there and it has been growing.

You see the re-election of the government in the Netherlands yesterday but you can also see that Netherlands, which was long time one of the most pro-European countries, has shown increasing tendencies in recent years to pull away from its commitment to become a very vocal euro-skeptic. And I think this is symptomatic of the difficulty Europe is having. Of course, some of that revolves around the difficulty any political leaders will have supporting other countries during a time of malaise and economic weakness at home. We see this in all of our economies. And of course, some of it has to do, however, with the unfortunate failure of European leaders decades ago to erect, conceive, and develop a structure for Europe which brought fiscal unification alongside monetary unification.

Many European called for this, in fact. Previous chancellors of Germany called for this but it didn't happen. I think to a certain extent that Europe and we all are paying the price for that. Markets have a role to play here as well in the debacle which surrounded Greece and which surrounds Europe today because investors are not just banks.

With little regard for the sovereign risk involved, with little regard for the fact that underlying those appealing spreads in Greek debts, at the end of the day it should have been no surprise that they were not able to realize the whole value as a result of negotiations indeed. As you have already heard, the Greek debt restructuring was the largest sovereign debt restructuring in history, and the private financial institutions led by the IIF, through negotiated settlement, through a voluntary deal, gave away 73% of the value of our claims. Over 107 billion euro in face value was wiped down and 35% of the remaining face value of the debt was converted into long term paper with very low interest rates.

This was necessary to create a window of opportunity for Greece to give them some breathing space because they were being crushed by their debt. At a time when it is not easy to hear complimentary remarks about Greece, I will say a couple of things. I admire their dedication to reaching this agreement voluntarily. This is very important for how this system works because a little over a decade ago, a rather important Latin country, Argentina, also faced an insurmountable debt. But rather than working its debt problems out cooperatively, it took a unilateral approach to its creditors. And as you well know here in Korea, when difficulties, either at the corporate level or at the sovereign level, arise between debtors and creditors, they're always best sorted out cooperatively through long and sometimes difficult negotiations. That's what we did in the Greek case. It is not what Argentina did that they still suffer today for failure to access global capital markets. Here I would give a great deal of credit to former Prime Ministers Papandreou and Papademos, both of whom showed a commitment to negotiated solution when it could have been tempting to simply walk in to the creditors and say "No mas (no more), we're not paying you anymore, not a cent, not a euro. We're simply going to default." It would have been dangerous not just for Greece but for Europe as a whole. A disorderly default of Greece could have thrown Europe into chaos and I for one believe that a Greek exit today still has the potential to throw up into chaos.

Many debate this. Many say that the markets are prepared and that the governments are prepared. But a few simple facts make you realize that is not the case. The ECB claims on Greece are roughly double the size of the ECB's capital base. If Greece exits the euro, re-denominates its currency back to drachma or some 21st century version of it and what value would those claims have? What value would the capital stock of the ECB have? Now you can say the governments of Europe would need to recapitalize the ECB quickly and they would, but could this be done in an orderly fashion? The same governments who moan and groan about an additional 10 or 20 billion euro? Are they going to write a check overnight for 200 billion euro? I doubt it. That is not even taking account of the potential contagion effects which a Greek exit would have on Spain, on Italy, on Portugal, potentially on France and other countries.

The fiscal construct of Europe today is quite fragile. After long and hard negotiations, I am pleased that we were able to put into place a solid piece of work, rescheduling the private debt. It was difficult not just because of the severity of Greece's economic problems and it is one of the most inefficiently structured economies I've ever seen. For years during my Treasury days, during my JP Morgan days, and during my years at the Institute, I've worked with many, many sovereigns. I've seen some poorly organized economies in my days. I've seen some poorly managed economies. I've seen some misguided economic policies. But I've rarely seen an economy so inefficiently structured at its core; it's Greece. They have a huge amount of work to do and frankly the process of negotiating a solution on this Greek debt was so difficult that I began to learn that in order to sustain my morale I always asked for a room at my hotel which had a small view of the acropolis. Because after a long and discouraging day at the Prime Minister's residence, I would come back and look at the light shining the acropolis and suddenly I would think, "Well, maybe we can get something done here in this country." I needed that extra dose of inspiration because without it, it was not easy at times to sustain the energy and the focus needed to bring these negotiations to a successful conclusion.

One other difficulty though which hovers over Europe today, and I was just talking with your Vice Foreign Minister, the former Ambassador there, who probably knows this as well or better than I do, is the dysfunctional decision making process of Europe today. They have the eurozone, 17 countries, and the EU, 27. They can't seem to get a comfortable position between the two now, particularly with one important EU member that is not eurozone, the UK, but you have other Scandanavian countries, which are at various stages of engagement in this process. Some members at the EU are not the members of the eurozone, others good neighbors but not even members of either construct. You've got Switzerland in the middle there trying to look left, right, front, and back and keep its head above water. You've got a decision making apparatus which is not suitable for today's modern world of finance. Every country in the eurozone had to approve every dimension of this Greek debt restructuring. That is absurd if you imagine.

I had a call one day after long and difficult negotiations over one technical piece of steel. The deal related to a GDP warrant, which is an upside kicker, which the creditors would receive if growth in Greece exceeds expectations. Greece accepted the rationale for this because we said, "We're giving away so much of our claims because you have a very weak capacity to repay your claims. But if your future capacity is enhanced, then you could perhaps remember us and send us a little extra money along the way." And they agreed. It's sensible and it's been done in other cases. The Germans approved it, the French approved it, the IMF approved it, but the Dutch Finance Minister Jan Kees de Jager rang me up and said, "I will veto this." And I said, "Why would you possibly do that?" and he said, "My staffs tell me that it's too favorable for the creditors." And I said, "Well, do you really know how it works?" He said, "No." And I said, "Well, look, I've been working on this days and nights with the Greek Prime Minister and we finally found out a solution and I need your approval because every one of the ministers has to approve it. And we need it by tomorrow to get full approval of the eurozone ministers at a meeting taking place." And I said, "If you do not understand it and you require, I will get on the plane tonight and we will spend three hours tomorrow because that is what it will take, three hours, for me to explain the technical details of this to you. I will try my best to convince you that it is a balanced, fair approach." I said, "If you don't have three hours on your calendar in the morning, then please, please, concede that this deal should go ahead." He quickly acknowledged that he did not have three hours and he ran up his white flag and agreed to this proposal. But I should have never been in a position and the Greeks should have never been in a position to have to defend every technical piece of this negotiation with every government in Europe. The politics run very high in Europe today as they do in many countries. The populism runs quite high. The parochialism runs quite high. It runs high in my own country.

In spite of these difficulties, I believe Europe is making progress. I would say the actions of ECB last week are potentially a turning point, but only potentially, because now the governments will have to decide how to get their part of this solution in place. Immediately you need Spain to ask for a program and that is proving very, very difficult. We've been working with the Spanish authorities and we have been struggling to convince them that it is in their interest to seek a program here because the tap of the ECB liquidity, the big guns on the deck of the ECB battleship, will not be used unless Spain goes to Brussels and says "we want a program". There are various political reasons why the Spanish are hesitant. But I believe at the end of the day they will have to swallow their political pride. It's not easy. You learned that in Korea. 14 years ago, right? Swallowing political pride is not easy. The US pride was hurt when the rating agencies started looking negatively at us because we couldn't deal with our physical debt ceiling last year. Korean pride was hurt when you had to swallow an IMF program. But once you decided to do that, you put all of your energy and focus into it and managed to use it as an opportunity to strengthen the underlying competitiveness of the Korean economy. This is what Spain, Italy, Greece, and many other countries need to do today.

The move toward a banking union is a positive one. But again so many pieces of this European puzzle remain unresolved. It's one thing to put a eurozone-wide or an EU-wide umbrella over banking supervision. It's another thing to decide who will pay the price if a large French, Spanish, or Italian bank fails. Is it the French, Spanish or Italian tax payers? Or is it all the eurozone? All the EU taxpayers? These issues are not even addressed in this current proposal. Of course, nothing good is being done today in Europe. It suggests to me that there is a consensus toward fiscal union and a vision toward what Europe should look like economically and politically in 15 or 20 years. Without that medium term game plan, it is highly unlikely that markets will be assuaged on a continuing basis. There needs to be a combination, therefore, of short-term actions by Spain, resolving the current tensions that surround Greece, and supporting Portugal and Ireland. There needs to be progress on the banking supervision. But there needs, more than anything else, to be a coherent medium term goal that is articulated by the European leaders. That, very unfortunately, remains very, very elusive.

The other difficulty which Europe faces today is the difficulty that we see in so many parts of the world, that is, no growth. It is very hard, and I would say in the end virtually impossible to regain a comfortable level of debt to GDP once you have a high debt level and if your economy is contracting. So, the basic fact of economic law: if your economy continues to shrink, you can take a whack at the dent, but before you know it, the economy's shrinkage offsets the improvement you're making and makes it more difficult to achieve further debt reduction because of the lack of revenues. There's an old children's story in the US about a tiger that chased its tail around a maple tree so long that the tiger turned into maple syrup. Well, in a way, this is what Europe is doing right now by requiring so much emphasis on short term budget cutting that they're actually undermining the longer term goals of fiscal consolidation and debt sustainability. You take every ounce of wind at the sails of even the most impressive sailing boat. It will not go anywhere. It will sit in the doldrums. And this is unfortunately part of the problem which Europe faces today; too much emphasis on near term fiscal belt tightening and not enough on medium term structural reforms. It comes back to the issue of competitiveness. There is whacking today in Europe and unfortunately, in some sectors of the European corporate leadership, a culture of competitiveness. Until the government decides that they want to create truly competitive economies that can compete with Korea, that can compete with China, and that can compete with Brazil and the United States, these problems in Europe will continue to hover all of us.

Just a moment or two on the US and this part of the world, and then I would like to conclude my thought on global coordination. The US, as you are, is facing an election quite soon. There is nothing unusual about that. We've been doing that now for 230 odd years. But we've seen increasingly unable to define political leaders who are able to work with others across the aisle to find common ground of our medium term fiscal problems, the urgency is growing. If you want to worry about a country with debt sustainability problems, don't worry about Greece, don't worry about Italy, and don't even worry about Japan. Worry about the United States because the outlook for our debt to GDP ratio, as we move through this decade, is quite bleak unless we can solve our medium term entitlements problems. The debate which you see now between the political parties over benefits and governments spending on the one hand and the tax increasing on the other hand is an important political debate. But the real issue is that, like Europe, we have created an atmosphere of entitlements in our economy which are not sustainable by the current tax structure and would only be sustainable with heavy additional doses of taxes on US citizens and US corporations and I doubt that is very compatible with a competitive thriving US economy.

We will face some difficult decisions soon and everyone can look at this so-called fiscal cliff and say the politicians will find the solutions, but it's not that easy. They need to find solutions that not only enable the current growth to be sustained, but they need to find solutions that will give confidence to markets that the medium term problems are under control. That's not going to be easy and I've seen little evidence so far that leaders in either party are really prepared to roll up their sleeves and do what it takes.

There's another feature in the global outlook which warrants a brief word and that has to do with deleveraging and regulatory reform. I was in Jackson Hole a few weeks ago when Chairman Bernanke of the Fed gave this speech where he telegraphed pretty clearly his intention to do what he did yesterday. The next morning I had the opportunity over breakfast to discuss with him the ineffectual nature of US monetary policy because it is certainly giving markets a lift. But the housing market in the US still remains weak although showing finally some signs of recovery. Credit availability for small and medium size enterprises and many households is highly constrained. The pressures on financial institutions to reduce their balance sheets and build capital are quite substantial. This is an American reality. It's a European reality. You know it very well because it was part of the G20 agenda for a number of years. Well, it is all well and good to strengthen the regulatory framework and I think we would all acknowledge that after the crisis of 2007-8 higher capital liquidity requirements were needed. But are we not overdoing it? Is the regulatory pendulum not swinging so hard and so fast that what Bernanke and his colleagues are trying to do with easy money is being partly undermined by his own regulatory policies?

They tend to view this in the US and in many governments as totally independent features of policy making. The finance ministries around the world seem unable or unwilling to reign in the regulatory excesses. Why? Because it's popular to beat on bankers. Of course, it is! It's popular for politicians all over the world to blame the banking community, not just for its role in this crisis. Let's acknowledge this. The banking community did play a role in catalyzing and planning some of the seats for this crisis which enveloped the world four years ago. Poor risk management, poor governance standards, inappropriate compensation structures, and weak underwriting standards. All of these were weaknesses in the financial community. But did we really have a global economic crisis solely because of those factors? I think any rational analysis suggest not. Misguided policies, weak regulation, and inadequate supervision clearly played a role. Global imbalances played a role, but you won't hear that said by any global political leader because it's more popular to blame the bankers and then pile on regulatory reform. You cannot rebuild a global economy unless political leaders realize that financial institutions are their partners, not their enemies. This is partly a task of the political leaders, it's partly a task of the financial community itself to steadily work to rebuild its own credibility and this is not easy to do. Mistakes continue to be made as we've seen this summer. Credibility continues to be damaged, but just as the Korean banking community has rebuilt its credibility impressively after the role that they played in the crisis here some 14 years ago. The global banking community has a job to rebuild its credibility and frankly, the banks from the US and Europe can learn from what emerging market banks have done to strengthen their balance sheets, to strengthen their risk management, and to rein in highly risky activities.

On a final point, I reflect on the impressive and remarkable work which you did, working with President Lee in chairing the G20 a few years ago and I reflect upon the evolution of the G20 process. The fact is that G20 has done some useful things in the last few years, but it is still not making enough of a difference in creating a framework for coordination of global economic policies. National policy makers still seem to feel that their obligation is not just first and foremost to their own country, but first, foremost and solely. Now that's a bit of an exaggeration because there are, at times, efforts at global coordination and cooperation, but they're weak, they're insufficient, and they seem to deny the reality of interdependence which surrounds the global economic and financial structures today. Korean businessmen do have a right to be concerned about the policies of China, and the US, and Germany. Resilient businessmen do have a right when they complain about QE2 because it creates liquidity which drives their exchange rate and undermines their competitiveness. There are no easy solutions but unless we and the global economic and financial system strengthen the framework for coordination of policy making, I'm afraid that our future will continue to be marked by episodic and painful and costly economic and financial crises. Thank you for having me with you here this morning. It's a real pleasure to be back and I will be delighted to participate in the Q&A session.

Dr. SaKong: Thank you very much for the very, very illuminating and insightful presentation on global financial and economic affair, particularly the European crisis. You covered a wide range of issues for which I'm sure there will be many questions and comments from the floor.

Minister Taeshin Kwon: Thank you very much, Dr. Dallara. We've learned a lot from your first hand experience in dealing the great debt issues. As you have said, I think the Greek problem and the sudden European problem is not just an issue of liquidity, but also of insolvency. How to overcome insolvency problem? The only way is to enhance your productivity or depreciate your currency. But depreciation is not possible when you are in Europe. Then, there should be enhancing productivity by reforming the government or the entitlements or social welfare system. But it is very difficult.

And by using the tight fiscal policy, it will reduce the economy and more difficult to get benefits. I'm with you. How can they solve their problem? We have experienced the Korean financial crisis, Lehman Brothers crisis, or the Great Depression. And every time we have found ways to overcome. I think we should be a bit more optimistic. But in this case how can you be optimistic? What if Greece came out of Europe and used the old drachma? Then that would make a big problem, too, because the issues of creditor and debtor in denominated euro. How can they change it? What do you think of the future prospect within the next 2-3 years? Can they solve the problem or will Greece go out of the eurozone?

Dr. Inchul Kim: I am Professor Kim of Sungkyunkwan University. Thank you for your insightful presentation. I've had two questions. One is about the 3rd round of QE. There's a criticism about Bernanke because at the present time, the real interest rate is inane although you call it a non-traditional monetary policy. The interest rate is between 0 and 1 percent. I would like to hear your comment on what's going to happen. They are afraid that that's going to invite more serious problems later on.

Another question is about the euro crisis. Czech President Vaclav Klaus expressed a great concern that currently their free market capitalism is greatly being challenged. He sensed that socialism is coming back in Europe. I wonder if you were able to sense that when you were in Europe.

Marjo Crompvoets: My name is Marjo Crompvoets, the deputy head of mission of the Netherlands. I just would like to make one small addition. I certainly do not deny the great amount of euro subsiding in Europe and it's not going to change in the coming months or years because the problems are just too big. It's just that the outcome of the elections in the Netherlands, at least I think for many people in the Netherlands, is that there is going to be a small fine for Europe as well. If a clear choice of the public for the center for stability and for Europe and I don't say that it's a clear choice for the eurozone because the parties in the center have a slight difference of opinion on how to continue if you should continue paying for Greece and for everything. But for me at least and for many others, it's a sign that the Netherlands is going for stability and for Europe in general and they just hope it's a positive sign, a small one, the Netherlands is small, for the rest of Europe.

Charles Dallara: Let me try to respond first on your great point and question on competitiveness. What is the answer? How can one be optimistic? Like you, I try to maintain a certain degree of optimism because it's the only way to keep getting up with energy in the morning, isn't it? It is difficult to be optimistic. Nevertheless, I remain hopeful and somewhat optimistic that Europe will forge ahead by finally realizing the need to come to grips with these competitiveness issues.

If you look at Greece, one astounding reality is that private sector wages have taken such a hit over the last two and a half to three years that they have regained almost half of the competitiveness through unit labor cost that they lost during the prior decade of outlandish wage increases. And if they can get some control over government salaries, which they're struggling to do, I think you will find that this creates a window toward competitiveness. But it will have the need to be supplemented by much, much more than that. The protective structures, which surround professional industries, make it very difficult for entrepreneurs in new entrance to break into a wide range of economic activities in Greece today. The lack of a culture of tax compliance is a profound structural and cultural problem that is much worse in Greece than any other country in Europe although we see signs of it in other countries. The overall competitiveness issues surrounding labor market rigidities in Spain, in Italy, and in Portugal. These are finally being recognized and I think over the long-run, leaders in Europe will have to recognize that many of the benefit structures and many of the protective devices that they have surrounding the labor market are really not at all compatible with long-run competitiveness in their economies. If you talk to French businessmen, they are extremely critical of both the prior government's and this new government's approach toward raising more and more taxes and creating more and more constraints around corporate activity around the labor market movements, in particular in France today. There is, in the end, no way to avoid the necessity of being competitive if you want to maintain levels reasonably and socially stable levels of employment. Today, the levels of unemployment in Greece, in Spain, in Portugal and in Ireland are frightening. Not just frightening from just an economic point of view. They're frightening from a social democratic point of view.

The splinter party that almost took control of Greece this spring, radical and somewhat irrational, came into being with such force, not just because they had a charismatic young leader, but because the parties which have governed Greece alternately for the last decades are really discredited by the Greek people. They welcome privatization by the way. And I think privatization also holds promise. But I don't yet see it on the agenda efficiently in Greece, in Portugal and in Ireland as it needs to be. I think you're concerned about long-term competitiveness and it's very valid and I share it, but I do think there is a growing recognition that unless the structural rigidities that surround parts of the European economy are broken, their capacity to sustain jobs for their people in the coming decades is going to be increasingly constrained. Korea's not going away. China's not going away. America's not going away with its competitiveness edge. Obviously, all these countries have difficulties but I think that this issue of competitiveness is one that has to come into the forefront. I, myself, am a bit ambivalent. I question the potential effectiveness of a new round of asset purchases and I think to a certain extent that it shows a matter of frustration and a degree of inability of the leadership in Washington to find the right course with fiscal and structural policies. And so another round of QE becomes a substitute for that as I mentioned. I also think that there is a real question on the compatibility of current excesses to regulatory reform with the provision of credit. What is all this QE about? It's about trying to make a lot of credit available at cheap prices, low interest rate. But if the credit actually doesn't flow because the financial institutions which provide the credit are too constrained in rebuilding capital, then the effectiveness of the monetary policy is hindered.

You asked about socialism and Europe and I think you mentioned President Klaus. I had a very vigorous debate with him recently. I certainly respect what he has done for the Czech Republic and he's been a leading voice for capitalism around the world. But he's become such a euro-skeptic that I find his views almost intolerable because he would think that the only solution today is to take the euro completely apart. And I don't think it's either practical or feasible, to be honest with you. About the notion that socialism is going to come back to Europe, well, I don't think socialism ever left and I do understand some of his concerns because I think he believes that the current effort to support Greece and Spain is misguided. But you either have to, in the end, decide that you believe in the European project or not. And I think he simply doesn't believe it and his voice becomes sharper as he gets closer to the end of his term.

I appreciate the amplification and the insights shared by the official from the Netherlands. Indeed, I thought the election results did present glamour of hope. You can correct me if I'm wrong but I think it is the first incumbent government that's been up for the election in the eurozone that has made it through and I think it's a hopeful sign. It's just that I grew up professionally in the Treasury at a time when the Dutch finance ministry was not just one of the most ardent, but one of the most effective voices for the European project that I knew, and to see the skepticism influencing the policies and to see the barbs coming out of the Netherlands thrown at Greece steadily in the last few years has been a bit difficult. But let's hope that things move in the right direction.

Mr. Jaeyoung Lee: It seems to me that all nations, especially leading nations in the world including Korea, are facing with growing national debt. And I haven't seen any point in history or recent history where the governments have actually made efforts to reduce the debt. I see the necessity but do you see a possibility that we can resolve this issue and what would be the possible consequence in the future of this trend?

Charles Dallara: As I mentioned Mr. Lee, the longer-term solutions to the debt problems of Europe and the United States and other advanced, mature economies have to be a combination of long-term structural reforms including getting control of entitlement programs which overwhelm the budgets of these countries. But it also has to be combined with reasonable rates of job creation and economic growth. I think that this can forge a path. I think back to the efforts to shed the burden of debt which the Latin countries dealt with in the late '80s and early '90s and indeed they used the opportunity of the Brady Plan not just to throw off 30 or 40 percent of their debt but to revitalize their economic structures, enhance the competitiveness, and move into a period of sustained growth. And I think that has to be the key here that you allow these countries like Greece, Spain, and Italy some near term slack. But you insist, if I were sitting in Berlin, on the structural reforms which can bring longer term budget projections under control and can enhance competitiveness. The Greek debt reduction is a huge opportunity. We eliminated more debt than has ever been done in history but it will go for naught unless they can re-establish growth. Right now, the Greek economy is contracting at six to seven percent. The debt to GDP will continue to look grim. So I think again it's a combination of determined efforts over time. It will require, I think, a different breed of political leaders to do this and I'm not sure if the "advanced" economies of Europe and the US are breeding these leaders. But I think the people are eventually going to tire the lack of solutions and the burdens on future generations, particularly given the demographics and many future economies these days are quite worrisome. I think this has to become fed into the political debate more and more as we look at long term solutions to debt.

Dr. SaKong: While others think about further questions and comments, why don't we turn our attention to our part of the world? What's your take on the Chinese economy? And how do you see Korea from your vantage point? One of the hot political issues is economic democratization. How is it received by the foreign community, particularly from your vantage point?

Charles Dallara: First, a word about China. I think there are two different ways to look at the Chinese economic situation, going forward. In the near term, obviously, one has to be somewhat concerned. Growth is flowing much more than many had expected largely because of the supreme export performance. I mean China has grown as an exporter in these last decades. It appears that that model is beginning to lose momentum. Now China has certainly been striving to boost domestic demand and domestic consumption. It made some headway. But I think China is facing a point where it will need to alter some fundamental aspects of its domestic economic structure. Much more deregulation of the financial system, much more advanced development and social safety nets in order to achieve the kind of development of domestic demand which is really needed for substantial advancements. Obviously, these are not easy things to do and I think China steps back.

The model that has surged China so well for almost three decades, it seems to me, is in serious need of refurbishing. And it's not clear at all again that the political leadership is well positioned to take the necessary steps. We, of course, have to see the transition coming in China. And just like transitions in your country and my country, we don't quite know what they will bring. But I do feel that China is to revamp its export industries, revamp the domestic financial system and revamp the social safety net if it is to sustain its economic performance. And I think it is, perhaps, not realistic, even with these changes to expect that the Chinese growth over the next decades will compare with what we've seen in the last few decades and you've seen this in Korea.

In terms with Korea, I will have to acknowledge that I'm not as close to your current situation as you are. I do have the impression that the Korean competitiveness and the overall performance of the Korean corporate sector remains quite high. And to me this continues to be the key to the future of Korea. We're having an interesting debate with colleagues and some other Korean friends on whether Korea has become too dependent on China. But I think it is important that Korea broadened its global relationships. It's surprising to me that the Korean economy is not more integrated, for example, with the Latin economies of the world today. I think this is something that we're looking out to the future one has to deal with.

I think Korea has made progress on developing as the financial center. Perhaps the progress has not been as rapid and as convincing as some of us would like to see. I think that you've still got a lot of work to do in this area. Every government has to decide whether they are committed to this as a goal. And as we were discussing over the breakfast table earlier, when I see transaction tax on derivatives, I wonder how consistent this is with the country that says it wants to build Seoul as a financial center. I think the issue of economic democratization is one that I need to better understand to be honest with you because we see signs of it in other countries as well. If it's motivated by a growing concern about the gap between the wealthy and the less successful members of your society, I can understand. But I would certainly approach it with a bit of caution because I think that there are no easy solutions to these issues of economic absence. Certainly in my own country, the tendency to point fingers at the wealthy is beginning to be troublesome from an overall, societal and competitiveness point of view and I for one am not a great fan of the tendency to point a lot of blame at the wealthy. Of course, it needs a fair distribution of tax burdens in the new society and a fair set of opportunities. To me, Korea needs to continue to enhance your openness. Over the years, Korea has vacillated your attitudes towards being a truly open economy. And you, at times, showed the tendency to be even-handed and intrigued foreign firms and foreign businessmen as you would with your own, and at other times, frankly you behave in a very still, occasionally surprisingly, protectionist fashion. This is just my observation and while I think the overall progress has been one of openness since I remember the days I saw small little booklets circulating in grammar schools here that complained about foreigners back in the '80s. I think overall, Korea has grown increasingly comfortable with the notion of an open and competitive economy and society. I recognize, given your history and your location, this is not an easy thing to do. But I would certainly continue to stress the importance of this for the future of the Korean people.

Dr. Oh-seok Hyun: My one comment is about the future prospect of the Korean and world economy. In the first quarter, there was some kind of optimism prevailing. The IMF upgraded its forecast for the world economy overall. I think because at that time, market sentiment in some sense gave credit to the policy efforts of European countries as for the Greek issue, etc. But suddenly, in the second quarter the world economy plummeted because of the skepticism. I am a little bit of a cautious optimist. I still believe that this time is different. The ECB adopted the ambitious program and another round of QE has been launched. The market might believe that this time there might be some kind of solution. That might mean a little bit better prospect than expected. I just want to hear your comment. Another question is that considering this kind of ambitious QE or liquidity provision by ECB that might induce investors to turn to Asia. That means that we can expect more and more capital inflows to emerging markets, including Korea, in the future. It will also mean more currency appreciation. What is your view?

Charles Dallara: Well, a lot of different issues you've touched upon. Let me just try to deal with the two of them. First, I do think there is a reason to be encouraged as markets are by the recent actions of the ECB and more recently the Federal Reserve. But I would caution that that encouragement particularly in the case of Europe can evaporate quite quickly if some of the other pieces of the European puzzle do not fall into place, in particular, if the path forward for Spain is not clarified and in particular, if there is not renewed agreement over another phase of financial support for Greece economic reform. These are two immediate vulnerable points in the European landscape. And if it becomes clear that this beacon of ECB cannot be turned on because the Spanish government is not prepared to go, then the markets can quickly take back in three hours all of the improvement in the market that they have developed in three months. So I think we're approaching a very critical time here, vis-à-vis Spain and less so but also for Greece. Greece was running into serious problems, meeting its financial needs by the end of October. Spain will run into serious problems, financing its government debt by sometime in November, unless decisions are made in both cases. Right now it's very hard to see growth in Europe in 2013. We forecast a very slight uptick from mild negative growth to mild positive growth but I doubt that's going to happen unless these problems are dealt with aggressively vis-à-vis Spain and in Greece. Also unless they re-orient these economic programs away from short term austerity, which I think is part of the problem as well, the capital flows to emerging markets, I think, will continue to be a feature of the world going forward, including Korea to Brazil to China. Obviously, a lot of investors are sitting on sidelines around the world and obviously the US equity markets remain an attractive vehicle although Americans themselves are still much less invested today in the US equity markets than they were five years ago because they feel burned by the financial crisis, of course. But I think Korea will have to accept the reality, going forward, that you will have to deal with substantial amounts of capital flows and you will need to formulate your policy with that in mind.

Dr. SaKong: Mr. Dallara has other schedules today and he has to leave this evening to China. And he's everywhere because of the European problem which is a financial problem. So he has to play a very important role. Anyway, we are so glad to have you and share with us your very illuminating insights. Thank you!