Forum for Economic Dialogue 2012 – a successful inauguration

The UBS International Center for Economics in Society invited leading economists from around the world to enter into a dialogue with top representatives from the private and public sector to debate on the future of the international financial system. The inaugural "Forum for Economic Dialogue" was held in Zurich and enjoyed an overwhelming interest.

Leading economists took it in turn to address the critical issues confronting the international financial system today.

What has the financial crisis taught Jean-Claude Trichet? The current chairman of the G30 and former president of the European Central Bank acknowledged that central banks and supervisory authorities spent too long thinking they were safe after the dotcom bubble burst. Following the Lehman Brothers collapse in the US, risk aversion spiked dramatically and numerous US investors brought their overseas foreign currency investments back to the US, temporarily bolstering the US dollar. However, Trichet believes that the currency is on the verge of losing its "exorbitant privilege" and special status as a global reserve currency.

"There is no more risk-free asset."

Trichet outlined an emerging tripartite system, in which the US dollar will only play a leading role in the US itself, the Gulf States and the emerging markets. At the same time, he believes the euro is likely to become more significant in Europe and the Middle East, with a third power emerging in Asia centered on the Chinese yuan. Unsurprisingly, Trichet stressed the robustness of the euro, which has maintained its position as a strong currency since its launch. He argued that people generally need to say goodbye to the notion that there is such a thing as a risk-free asset. Government bonds are a good example of this. The risks need to be factored into credit ratings on a case-by-case basis.

Jean-Claude Trichet, Chairman of the G30 and former President of the European Central Bank, delivered the opening lecture

Prof. Jordi Galí, CREI Barcelona, during the session "Monetary Policy and Currency Markets in a Volatile World"

Theory faces headwind

Spanish economics professor Jordi Galí dismissed the belief that interest rate hikes (a "leaning against the wind" policy) can slow down or reverse rising asset prices, stating that it is based on incorrect assumptions. He argued that bubbles result from excessive growth expectations, and demonstrated that interest rate hikes actually exacerbate the creation of bubbles and price volatility. In short, "leaning against the wind" can work, but only if the bubble is small. The tricky thing is that it is almost impossible in practice to reliably determine when a bubble is a bubble, and how small or large it is.

Deputy Swedish central bank governor Lars Svensson also argued that interest rates are not the right tool to prevent price bubbles. In the case of an impending real estate bubble, interest rates would have to be increased drastically to achieve the desired price correction. Such an action would have knock-on effects on employment and GDP. The result is a trade-off between the positive influence of declining real estate prices and the disadvantages of higher unemployment – a delicate situation both politically and economically.

Bonds as remedy for the eurozone

Turning to the issue of "safe assets," Princeton economics professor Markus Brunnermeier stated that the defining feature of "safe assets" is their relative stability, irrespective of their status as "safe assets" in the eyes of investors. As a solution to the European sovereign debt crisis, Brunnermeier proposed creating European Safe Bonds (ESBies), which would be issued in place of government bonds alongside higher-risk junior bonds. In the event of insolvency, losses would be absorbed exclusively by the holders of the junior bonds. As safe assets, ESBies would not be affected. The movement of capital among countries would be replaced by shifts between the two bond categories.

Taking a more global perspective, Hélène Rey discussed possible developments of the new international financial system in a world where the relative size of the US shrinks. In particular, she proposed alternatives to US Treasuries as the dominant reserve asset, and suggested to put more emphasis on external balance sheets of countries.

"We should track the external balance sheets of countries to better understand financial vulnerabilities."

Switzerland under the microscope

Switzerland, with its long-held safe-haven status, was the subject of a panel discussion between Kaspar Villiger, chairman of the Foundation Council of the UBS International Center of Economics in Society, Swiss National Bank Vice Chairman Jean-Pierre Danthine and Holcim Chairman Rolf Soiron. Villiger argued for the restoration of trust in the economy and intelligent location policy. Danthine would like to see Switzerland soon joined as a safe haven by other countries, while Soiron warned against government intervention and the presumption that the state can influence structural change or compensate for job losses through industrial policy.

MIT economist Daron Acemoğlu closed the forum with the first "Zurich Lecture of Economics in Society." In his keynote lecture on "European Success, European Failure," Acemoğlu recapped the thesis made famous in the bestseller he co-wrote ("Why Nations Fail"), which argues that a country's economic success is primarily determined by its political institutions. He argued forcefully for more institutional integration in Europe and was cautiously upbeat about the future of the continent's integration project.

While the audience at the Kaufleuten was probably split about such a need for more European integration, the overwhelming demand for attendance and the feedback received suggest that there was a consensus that the first Forum was a big success – to be continued.

Prof. Markus Brunnermeier, Princeton University, during the session "Financial Crisis, International Capital Flows and Investment Strategies in Uncertain Times"

Dr. Rolf Soiron, Haig Simonian, Kaspar Villiger and Prof. Jean-Pierre Danthine during the panel discussion "Is Switzerland Still a Safe Harbor in Turbulent Times?"

Prof. Daron Acemoğlu, Massachusetts Institute of Technology, during the "Zurich Lecture of Economics in Society"