

and return afterwards. Everybody knows this, but somehow few are doing.

But Boris Mintz is sure, that during this crisis a fundamental gap between practice and academia became evident. „Economics in US is regarded as the most advanced, but to be honest it could not only predict and offer preventive measures for the current crisis, but also did not demonstrate understanding of the ongoing events when the crisis was already flaring up“. Although, Boris correct himself, that it is not only about scientists, but also about politicians who often are deaf to the former. „Science might be able to explain reality and give recommendations. But if politicians will not show demand for research, nothing will happen. Thus it is not economics will lag practice, but reactionary thinking of politicians will lag scientific achievements“.

I remember when I was a student and took a course in public economics from one American professor. After he proved for us a long formula for calculation of an optimal tax I asked him, if it is being used for real tax rates calculation. He said that he struggles to explain it to students, what to say about politicians.

RETROSPECTIVE OF THE WORLD CRISES

Studying history always helps to understand better what might be waiting for us in the future. During the last 100 years the world saw many crises, and huge literature was written about them. Credit crises are probably the most interesting for present time. Great Depression which was thoroughly studied by Ben Bernanke working in academia is the most notable example. Also Northern countries (Finland, Sweden, Norway) crisis during the end of 1980s and beginning of 1990s. It is there first banks for toxic assets were created. Also Japanese „lost decade“ of 1990s, when government and business were waiting for better times and postponing painful restructuring of bad loans in the banking sector.

„It is impossible to avoid crises. But we can mitigate them by countercyclical monetary and fiscal policies, as well as effective regulatory system for financial sector“, — Mikhail Dmitriev believes.

FINANCIAL DAY

THE POST-CRISIS FINANCIAL ARCHITECTURE

The global financial order will be reformed without doubts. It is because almost all countries including USA are interested in reforming it. The goal is also common — to decrease the risks in financial system through rise in transparency and control. But in reality it is more complicated. New financial products are very complicated for regulators to assess their systemic risks adequately, even inventors of those products failed to do it many times. If regulator can not assess the risk, he most likely will freeze the production until complete study, as it is done with drugs, for example. This will increase the costs of innovations, and companies will prefer to start them up outside such regulation. In order to keep innovations home US and Europe will push all more or less financially significant countries to implement the same regulation. Most of those countries have suffered from the crisis and they are interested in reducing the risk if the burden will be shared equally.

And those will of countries created Financial Stability Board in this April, which now includes 21 major countries and EC. FSB will start with monitoring of large hedge-funds and proceed with all other systematically important financial institutions and instruments.



LARGE CITIES WILL MOST LIKELY GROW FURTHER

Among other things, FSB will assess contingency plans of those companies developed for cases of market distress or even bankruptcy.

Russian banking sector soon will probably need stronger medicine than monitoring and advice. Delinquencies are growing together with reserves covering them causing banks profit plunge.

Even after Central Bank of Russia eased definition of bad loans by increasing period of acceptable payment delay on 30 days from January 1st of 2009, share of loans with overdue payments in the bank system is about 10–30% by an estimate of Alexey Ulukaev, CBR chairman deputy. During the 1998 crisis IMF estimated that share in 40%.

„I would estimate the share of overdue loans in the banking system on the level of 15%. Share of completely hopeless loans, of course, is significantly lower. But it is not only loans. Among toxic assets there are bonds with technical or even complete default. In the beginning of May there were more than 175 bln RUR and \$640 mln of such assets“, — says Boris Mintz.

There are several ways of solving the problem of toxic assets. It is possible to ease reserve requirements for banks and let them accumulate bad loans in the hope of after-crisis rise when banks profit will allow writing them off or companies will repay at least some of them. In such hope Japan lived through its lost decade. It is also possible to create state funds for toxic assets as it was done in Northern countries, or state-private funds as in US. It is possible to stimulate M&A processes and capitalize banks from treasury. In any case the problem of bad loans will have to be solved in Russia, possibly, in a combination of those ways.

THE FUTURE OF RESERVE CURRENCIES

On the previous Forum there was a question for Herman Gref if Russia would be a part of Eurozone in the next 20 years. „It is a good question. Russia will use Euro or Eurozone will use ruble? I think chances are 50/50. And even more chances that we all will use Renminbi“, — he smiled.

For the last 10 years we saw the rise of Euro as a competitor for dollar. As Caio Koch-Weser, Vice Chairman of the Deutsche Bank Group, put it last year on the Forum, there are

more cash and coins in Euro than in USD already. In 2007 almost 50% of bonds in the world were nominated in Euro and only 35% in USD; 40 countries directly or indirectly pegged their currencies to Euro and 60 — to USD; 26,5% of the world central banks reserves were nominated in EUR and 64% — in USD, but Euro share is growing, for example, in 2003 it was only 19,7%.

Menzie Chinn from University of Wisconsin and Jeffrey Frankel from Harvard using data for more than 20 years assessed the impact of different factors on currency share in the world reserves. It turned out that GDP of issuing country, inflation lower than average over developed countries, appreciation of the currency and low volatility increase that share and vice versa. Central banks appear to behave like portfolio holders. But there is big inertia in those portfolios — half-life of deviation from equilibrium is 12–17 years, but authors admit that there should be some bifurcation points, when changes are almost sudden, like it happened with USD replacing UK pound just in several decades.

If this model is close to reality, then Eurozone enlargement along with inflation in US after crisis is over will give Euro a chance to at least become equal to dollar in the world reserves. GDP of Eurozone is already almost equal to US one, and if Sweden, Denmark and especially Britain with its financial sector would adopt Euro, there will be no question who is number one. Nor Japan, neither China in the nearest future will be able to reach US. China GDP is 3 times smaller and it will take at least 25 years to reach US if the difference between their growth rates stays at 5%. But for Renminbi to become major reserve currency along with EUR and USD, China will have to limit inflation, keep currency rate and budget balance stable, and develop a major financial center, larger than in Japan. So far there are not so many reasons to believe that Chinese are not able to make it in 20–30 years.

Ruble perspectives according to this model are rather modest. Russian GDP is almost 10 times smaller than American, inflation is beyond CBR control, economy is based on extraction of natural resources and poor property rights hamper development of financial market. By the way there will be separate session on financial centers.

„To become a reserve currency ruble lacks stability. It is obvious, that a country which has just depreciated its currency and possibly will do it again in the nearest future, can not count on other countries keeping its currency in reserves. It is also hard to count on that because of double digit inflation. And besides one should do something if he wants his currency to become a reserve one, not only declare intentions. For example China supplies its currency through swap agreements. Comparing to China Russia has only one advantage — it has no limits on capital operations. If China does the same then chances for ruble to become a regional reserve currency might weaken substantially“, — says Boris Mintz.

THE FUTURE OF CITIES: PREPARING FOR ECONOMIC GROWTH

Edward Glaeser from Harvard, famous urban economist, has recently published an article „The Wealth of Cities: Agglomeration Economies and Spatial Equilibrium in the United States“. Using a theoretical model and empirical results he showed what instruments may make a city grow. Those are either cheap housing or increase in productivity. Of course, status of national capital adds a lot, but those two things are the only major drivers. Productivity may grow because of climate, geography, natural resources, or because of business climate and agglomeration itself. Studies show that in cities people faster accumulate human capital and produce more innovations. For example, it was discovered by Glaeser that city migrants' incomes grow not immediately after arrival, but simply faster than outside of cities, probably, because people inside cities accumulate human capital faster.

Moreover Glaeser shows that city growth in our times very weakly depends on natural amenities themselves, those like warm climate. And this in spite of active growth of population in southern cities of US during the past 50 years. Detailed analysis shows that the reason is not warm climate demand for which supposedly rose among Americans getting richer, but growth in productivity and construction policy of those cities.

Of course, large metropolitan areas will most likely grow further. For example, in US the highest growth during the last 80 years was observed in eight major agglomerations: Boston-Washington corridor, Los Angeles, San Francisco and so on. This growth will continue because personal communication enhances a lot innovation and trust, and distant means of communication can not replace it so far. Studies show that new patents more often refer to patents registered in the same area, and people more often call by phone those who live nearby.

But this growth is not guaranteed. If a city will limit construction and stick to the current economy structure pressing out innovation and productivity growth, it will see decline. For example, in Detroit and Cleveland manufacturing still dominates labor market and gives jobs to 20 and 16% of employed respectively. Detroit for the last 30 years lost 22% and Cleveland — 8% of their population. At the same time San Francisco grew on 17% and Chicago — on 14%. In the former manufacturing is not even in the fifth major industries: 23% of employed work in finance and insurance, 21% in professional, scientific and technical services and so on. In Chicago manufacturing gives only 11% of jobs, and just in 1977 it was dominant industry in almost all major US cities: Chicago — 36%, Detroit — 55%, Cleveland — 44. ■