

## **Teatro Series – Risk and the Future of the Global Economy**

The 3<sup>rd</sup> annual speakers series, held at Teatro Restaurant, Calgary Alberta, explores the key issues facing the economy.

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### **The World Economic Situation: A personal review**

Chrystia Freeland

*The following is an edited transcript of Ms Freeland's speech at Teatro Restaurant. Ms. Freeland is the former managing editor at the Financial Times in New York City. She is now global editor-at-large for Thompson Reuters.*

I wanted to start by telling you a personal story. What I'm going to talk about is what from my vantage point in New York -- traveling around for the Financial Times and now at Reuters -- the world economic situation looks like, especially in terms of risk. I don't want to sound too grandiloquent. I certainly wouldn't claim to have a crystal ball. I'm a reporter. But I talk to lots of people and I'll try to tell you some stories from them.

The story I wanted to start with was a story closer to home, a story about a conversation that I very clearly remember having with Teta Yenna, my Aunt Yenna. She was one of my Baba's, my grandmother's older sisters in Edmonton. She lived to be 100 -- she died just two years ago. They were a family of 13 but only four of them survived two wars and revolutions and made it out of the Ukraine after the Second World War. So my Aunt Yenna was a real survivor, and as I say, lived to be 100.

And I remember so clearly when I got into Harvard. This was a big deal for my family and I had to go see my Teta Yenna and tell her what I was doing and say goodbye. I remember she said to me, it sounds like a good university but what are you going to study there? I said that I didn't know for sure but maybe some literature, maybe some political science, maybe some history.

She was a little old lady even then, very big on her garden. She won lots of awards for her garden and she was very big on embroidery, too. And to be truthful, I thought that I was moving into a world far beyond her as I guess one does when one is 18 and leaving home. She said to me that I was making a huge mistake. She said she couldn't believe that I had such little clarity about what I was going to study. She told me that the ideas I had were completely stupid. She told me that I should study a hard subject -- engineering or medicine, or even chemistry.

And I said, oh, I kind of like math but this other stuff is really interesting. And she said, interesting? You have no idea what is going to happen in the world. When I was your age I also thought that it would be great to do interesting things. But one thing we found, our community found, as we found ourselves thrown into the world and we were really struggling to survive, was that the people who had the hard skills, who studied engineering or who were doctors were the ones who really made it and were able to make a new life in Canada most easily and bring the rest of us along.

Now, of course, I was a stupid 18-year-old so I ignored my Teta Yenna's advice and I studied Russian history and even a bit of

literature, God forbid. But I've been thinking about that conversation quite a lot since the financial crisis hit. So many people, it seems to me, were completely unprepared for a world in which what was important was survival and a world in which revolutionary change was happening. You had to be equipped to deal with that, and I have been thinking a lot about that generation. The generation of elders who lived through war and revolution are, in many ways, the people who have done best in this crisis. Think of the Paul Volckers and the Warren Buffetts. Maybe it's time for us to be thinking of some of those lessons.

Another person I admire very much who said something quite similar - - without the story of his Teta Yenna -- is Mohammed El Erian, the CEO of Pimco. I recently interviewed him at a conference and one of his messages was that his view about the global economy now and going forward, is that we are living in a time of very great change, very great volatility and very great unpredictability. He said the person not to trust is the person who tells you they know for sure what is going to happen next. He said, we manage nearly a trillion dollars and we have no idea what is going to happen. What we do know is things are very unpredictable and the best way to equip yourself – and this is a trillion dollar money manager's version of my Teta Yenna's advice – is to be prepared for radical change and be prepared for change that could be difficult and not good.

Another thing El Erian said which is really relevant to our responses to the crisis and how we are behaving going forward is that as a society, we in the industrialized wealthy West are very bad at this. Human beings in general are bad at it and we, culturally at this moment, are

bad at it. He said the investor behaviour he sees when people begin to suspect the world is changing in a bad way for them is something he describes as energetic inertia. People becoming more active but they are active doing the same thing they were doing before. He said that might make you feel good but it is not necessarily the right thing to do. In fact, it is often exactly the wrong thing to do.

And so his real advice -- and I think this is a very difficult point to contemplate as we sit here drinking glasses of wine -- for the next decade is to be prepared to spot dramatic change and be ready to respond to it. That is my overarching theme tonight, and then I'd like to speak about four important trends or themes that I see in the world right now.

The first one comes very much from my vantage point in New York and in the United States. I think a big moment that we are experiencing is America starting -- perhaps in a not fully digested way -- to appreciate that the American century is over. The world in which America is the preeminent hyper-power is over. I think Obama was elected partly because Americans sensed that he got that. You know, Rudyard talked about all of these eminent American intellectuals coming to Calgary and seeing what Calgary is like. In many ways I think that Calgary is less provincial than New York. There is a provincialism, a parochialism which is changing quite quickly in New York and in Washington. It's a parochialism which people who are not American and who live in smaller countries have not been able to afford to have for some time.

As an example, there was a study that some headhunters did of CEOs

in Britain and in the United States and they found that British CEOs were twice as likely to have had significant international experience or not to be British as American CEOs were to have had significant international experience or not to be American. Now, I am in no way anti-American. I think that this is largely a function of the fact that America is huge and until very recently you have been able to be an extremely successful business person without ever working outside the United States, except for maybe a two-year stint in London to show that you were willing to go outside the country. I suspect that if we did a study of people in this room very many of you have had significant professional experience outside of Canada, just because that is necessary in order to be a business person who isn't American.

So there us this growing understanding by American CEOs that the world is really a big place and has no borders, and that business seizes the global opportunity. These ideas are being embraced at variable speeds. I think that the business class and the business world have embraced these ideas much more quickly than the political world, for obvious reasons. Business knows no borders. At the risk of sounding Marxist here, capital has no borders. And I think you are now seeing more and more American CEOs whose resumes are perhaps not as international as those of CEOs in other countries, but who have very significantly in the past decade jumped at that global opportunity with an impressive agility and commitment.

The political class has done that more slowly. I discovered, for example, that Chuck Schumer – he's sometimes described as the senator from Wall Street -- had never been to China prior to 2006. I found that astonishing. But the political class doesn't need to be and to

some extent can't be as globally-oriented as business people, because their voters are American. This is already creating quite a significant tension and a tension which is only going to increase as the interests of business America are increasingly aligned with the interests of the world. Business America needs to be able to make investments in other countries if that is where you have the return on capital.

But Americans can't all do that. The politicians can't all do that so I see this as a coming point of tension and more generally, I think you should look to both an increasing realization by Americans that we're not the only ones. There is a difficulty in accepting that. It can be very hard to accept, though I think it is second nature to Canadians. But you know if you are used to making the rules it's very hard to accept that you are not anymore. I think it is difficult emotionally and ideologically, if you will.

I moderated a talk that Condi Rice gave and one of the things that really struck me was the intense emotional fervor with which she spoke about American exceptionalism -- America being the city on the hill, America being the best country in the world, the country with the best values in the world and having a God-given mission to embody those values and to share them with the world. And I think she did use the word "God."

It was really rousing, even for me, and it was really rousing for the audience. So if that is your starting point, moving into a multi-polar world where the forces of demography and economics are shifting power to other places is tough. That is observation number one. Observation number two concerns the matter of global financial

imbalances. When it comes to discussion of the global financial crisis there has been a lot of focus certainly on America and on the more homespun, easier-to-get-your-arms-around issues. If you're a Republican it's because those wretched Democrats made it too easy for poor black people to get a mortgage and if you're a Democrat the cause of the crisis was that those bad bankers did very bad things and got very rich themselves. Those tend to be the principal narratives. Another important narrative which is more complicated is the issue of global financial imbalances, with America consuming much more than it was producing and many countries, most notably China, saving much more than they were consuming. And those savings had to go somewhere and those savings have gone to the United States. The currency, I think, is increasingly going to be where this kind of Gordian Knot of global financial imbalances is really felt.

I think it's going to be very, very tough. It's hard for me to see a sustainable course for the world economy without those imbalances coming back into balance.

To be very simplistic, it's a matter of America saving more and consuming less, and China consuming more and saving less. But there seems to be a real reluctance to change -- not just in America but pretty significantly in China, as well. I'm not a Chinese expert but both by family background and as a reporter I've spent a lot of time in communist regimes and in regimes in transition. And one theory which George Soros has made about Chinese politics which I think is right on is that it's very risky for the Chinese state to be allowing the Chinese people to spend more money. You may well see the Chinese government spending more money, however. They have the biggest

and the fastest stimulus but that stimulus was all coming from the state.

Soros' point, which I think is very politically astute, was that they're smart. They know that they're a dictatorship and putting too many renminbi in the pockets of individual Chinese citizens is dangerous for them. So he thinks there's a very hard political constraint there. I happen to agree with him and I think that is part of the reason you're seeing the Chinese authorities being so resistant to allowing the renminbi to float. I think that is why they are resistant to the idea of those savings being reduced in any significant way.

This, I think, is going to be an issue that goes on and on, bringing me to my third point, which is the United States' side of it, and the issue of the United States' debt and deficit. I think it's worth extending now that we've seen the Greek problems and sovereign issues coming up not just with the United States but with Greece – they call them the pigs, right? Portugal, Ireland, Greece and Spain -- those are the European countries where the question is whether the national fiscal house is in order. I think this is going to be the third big issue that we see looming large.

How it affects you will depend on which neighbourhood you inhabit. If you're in Europe the overwhelming issue is going to be Greece. I was at a lunch in New York recently with Jim Flaherty, the Canadian finance minister. I was asking him about what he sees happening with the G7 meetings and he said that it was really hard right now having any kind of conversation with the G7 because whenever they all get together the Europeans are in a huddle talking about Greece.

He said that when they were in Iqaluit, he, the American representative and the Japanese representative went and looked at some igloos while the Europeans were trying to get their cell phones to work trying to figure out what they were going to do about Greece. So if you're a European the Greek issue looms very large and this obviously has an effect on everybody else. I think where we're going to see more and more focus is on the United States. And the issue of the American deficit and the American debt is really a monster of a problem.

What I find on the conference circuit is that it is a truth universally acknowledged by everyone from the guy who sells you hot dogs on the street to the Republicans to the Democrats to the economists that this is unsustainable. And there are two complicating factors, one which I think is under-appreciated both by the rest of the world and by Americans, which is the extent to which it really does seem that God loves America the most.

If you think about financial crises, if you think about previous big financial crises, the Russian and Asian crises in 1998, the Latin American crisis before that, they follow pretty much the standard scenario – that the country which is the epicentre of the crisis gets totally destroyed by global capital markets. It is generally forced to devalue its currency and if it has been stupid enough to issue debt denominated in foreign currencies it has to default on that debt. In short, it is really shattered and because it is shattered global markets then impose a really tough discipline on it.

What happened in the United States? They cause a global financial

crisis, the dollar is strengthened, and they sell t-bills out 20 years for practically nothing. So in terms of that pressure to be good, it is not really there yet and absent that real crunch from global markets it's hard for me to see a shift in American politics on this. Particularly because, and this is maybe a very Canadian observation, from the vantage point of anyone who is accustomed to a parliamentary system, Washington really is broken.

It is really hard to see in the American political system big, tough things happening. Health care is the most obvious example and as we stand back from the health care debate let's just remember that the Democrats control the White House, the Senate and Congress. They are not a minority government. They have healthy majorities everywhere and yet they can't get this bill through. Now, you may say, well what about the blue dog Democrats? Well sure, but what about party discipline? It is really hard to get things done and this came home to me recently.

I did a piece on the Canadian banking system and I tried to answer the question of why it was that Canadian banks, uniquely in the G7, didn't have to be bailed out. One of the people I talked to was Paul Martin and because I'm interested in the debt and deficit question I talked to him about that for a little bit. Paul Martin is close to Bob Rubin -- they're friends still today -- and I asked him whether he ever talked to Bob about debt and deficit. I asked whether he ever gave him advice about it, and Paul said that it was hard for him to do that. He said, I remember when we were in the middle of our big fight against the deficit I happened to be talking to Bob that day. I told him that I announced my budget that day and Bob said, that's great Paul, how

long is it going to take for you to get it passed? I said to him, we passed it today. We have a majority. We voted and that was it.

And that is something which is really important to remember when you're thinking about how America works and how America works in the world economy. I'm not totally pessimistic by any means. I'm a fan of the Churchill line that America always does the right thing after trying every single wrong thing first. I think it's a big mistake to bet against America but I do think that we are in this quite unique historical moment, when America as a country is facing some pretty huge domestic, economic and political challenges and has a political system which is actually designed to make it hard to do big things.

The fourth point that I wanted to mention is maybe slightly less obvious. One thing that I think underlies a lot of what we're seeing happen is the ways in which globalization and the technology revolution are the underlying economic drivers of our times, and are really having unequal results for people. This has been happening for a long time -- that inequality of reward -- but prior to 2007, particularly in the United States, I think that gap wasn't felt so much mostly because poorer people were using their houses as their ATMs and were able to build up a lot of credit card debt.

What you've seen since the financial crisis is all of that coming to an end and I think that is an underlying driver of a largely inchoate hostility that we're seeing to Wall Street and to big business in America. This is true even in the Tea Parties which are on the right, but which are populist and this is quite unusual in America. Americans like to think that they are the country where the rich aren't reviled, the rich are admired. But you're seeing some real revulsion

going on right now on both sides of the political spectrum, and I think that a big part of what is driving it is this sense not so much that Wall Street necessarily broke the rules but a sense that the rules aren't working for everyone. There is a sense that there has to be something wrong with a world where we have ten percent unemployment. Even if you're securely middle class you are not secure anymore.

And yet less than a year after the crisis, the multimillion dollar bonuses are back. The interesting thing for me is this sort of bewilderment that you have from the Tea Party nation you also have from the Wall Street guys. Because their feeling is that they're doing the right thing. Take Goldman Sachs, for example. They think they got it right starting in 2006 -- they started to short subprime and the result should be that they get their multimillion dollar bonuses again. If America believes in capitalism which we think it ought to, how can people be angry? We like to talk about Canada as the country of the two solitudes, but American capitalism is now a little bit a world of two solitudes and there's a real pressure there which I think could be quite dangerous.

The final point I wanted to make was to talk a little bit about Canada and what I see of the Canadian voice and the Canadian contribution. I should start by admitting -- and I don't think this will be a surprise to anyone -- that Canada is not often a topic in the business or political worlds that I inhabit. But I think it could and should be more so. I think that now in this world of revolutionary developments, Canada is doing a pretty fine job. Some of our national virtues are really ones which are standing the test of this crisis, and you know if I were a flack for the government of Canada I'd be telling people more about

them.

The most obvious one is financial regulation. Incredibly boring – yes, it’s a real snoozer to go out into the world and say, we're Canadians. We’re great at regulating banks! But we are. And that turns out to be a not inconsiderable virtue. To me the really interesting conclusion that I came to in writing my piece about Canadian banks was the real strength of Canadian regulation. I think of Canada’s conservative capital requirements, leverage ratios, quality of capital -- all of that much more conservative than in the United States or in Europe.

But what was interesting for me was how Canadian regulators were able to achieve that conservatism and hang onto it. Why didn't they fall prey to what one of my favourite economists, a guy called Willem Buiter, calls cognitive capture. Buiter was an economist at the LSE and now is the chief economist at Citigroup. After he was appointed to Citigroup he wrote a blog saying that since he now works for a bank he can no longer tell the truth. But before he had to become a liar he came up with this theory of cognitive capture where he said the big problem with regulators in the United States and Britain wasn't that they were corrupt -- the Michael Moore view of the world -- but that they were captured by the people they were meant to be regulating. And they started to believe that what was good for Wall Street or what was good for London was necessarily good for the community.

The really interesting thing about Canada is that this seems not to have happened here. The most interesting testimony that I found about that came from Don Drummond, who is now the chief economist at TD but who also had a long and distinguished career as a civil

servant. And he said to me, actually complainingly, that Canadian regulators and government officials are just so terrible when it comes to financial services. He said in other countries the regulators think their job is to be farmers, you know, to help grow our sector. Whereas our guys in Ottawa see themselves as policemen, and what they see their job as is to say no.

I can see how if you work at TD that would be kind of constraining, but to me the interesting part of this story is it turned out that having your regulators be policemen was better for the banks. They didn't have to be bailed out. People aren't yelling at them for taking government money and they're bigger and richer than they have ever been.

So I think Canada is quite good at finding the balance between a vibrant and aggressive capitalism and yet operating within a system where the government's job is to set the rules, to set the speed limits. I think this is really quite an important example for the world. And so on that bullish Canadian note, I'll conclude my remarks.