

Andreas Dombret: The future of global economic cooperation - Brexit, Basel III and beyond

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at a reception to welcome Olga Wittchen, Financial Attaché, as the Bundesbank's representative in London, London, 23 February 2017.

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1. Introduction

Dear Sam Woods
Ladies and gentlemen

It is wonderful to be back in London, a city so full of British, European and international flair. I am happy to see many familiar faces and numerous influential stakeholders from the City.

On one of my last visits to London, I heard someone say "The Germans like the British more than the British like the Germans." I hope that is not the reason behind the Brexit vote. In any case, it may not even be true – I have always felt there is a great deal of mutual respect between our two nations.

Actually, I am rather convinced that the British and the Germans put an equal emphasis on the mutual friendship and partnership. Yet, in times of Brexit and stalled international cooperation, we have to find new grounds for continued friendship and cooperation. When politics becomes emotional and confrontational, close personal ties and an understanding of where the other side is coming from are more important than ever. That's why today's event is important to me.

Tonight we are celebrating the arrival of our new Bundesbank representative in London. To mark the occasion, I would like to say a few words on how we can stabilise and improve global cooperation, and discuss two current sets of negotiations: Brexit and Basel III.

2. What is the future of global cooperation?

When talking about global market liberalisation and economic cooperation, we hear extreme, ideologically motivated solutions all too often: for instance, populist nationalism promises that everything will get better if we build new walls between our societies. At the other extreme are those who favour hyper-globalisation, that is, no borders to economic activity at all and full harmonisation.

History has proven that both solutions are mere ideologies. The theories of both sides have proven to be unrealistic and in considerable part, plain wrong.

So what form of international economic coordination is actually viable?

To answer that – without giving a long lecture – we can borrow a simple yet powerful analysis: the globalisation trilemma. Dani Rodrik, a well-known economist from Harvard University, argues that we face the following trilemma: we cannot have all three things at once: (a) full, global market liberalisation, (b) national sovereignty, and (c) democracy. We must choose two of these three, and give one up.¹

If we choose full economic globalisation, without any obstacles to free trade, then we must give up either our national sovereignty or our democratic ability to oppose global rules. For example, if we give up democracy, an autocratic ruler could decree that everyone has to accept the global

rules. If we give up national sovereignty, we could have a global democracy. I think it is fair to say that we would rather not give up democracy or national sovereignty.

What remains is to limit market liberalisation, where our societies deem this necessary. This is not a convenient truth, because it means we have to look for answers in less clear waters: we need to find those areas where global cooperation and harmonisation is sensible, and how far it can go. This strategy must then go hand in hand with more national autonomy for finding domestic solutions to national challenges.

Given these constraints, a realistic middle ground would be focused global cooperation: continuing to cooperate and to harmonise regulations, where possible – but also focusing and improving our efforts. Focused global cooperation would also offer greater scope for solutions that respect the legitimate interests of countries wanting to run their economies independently.

3. Brexit

I'd like to discuss briefly what focused cooperation would mean for Brexit negotiations and the future relationship between the European Union and Britain.

I think it is fair to say that we are searching intently for a workable solution that ensures friendly collaboration. Yet the scope of possible solutions is limited by the British decision for a hard Brexit, as well as by the EU's understandable prerogative to prevent cherry-picking.

One of the possible scenarios we now have to imagine is making cooperation possible in two legally distinct jurisdictions, with different legal frameworks. This would mean that firms would have to comply with partially-differing rules. To continue serving their clients in the other jurisdiction, it might be wise for banks to check if it is viable to open branches or subsidiaries in the respective economic area.

In such a scenario, close coordination between supervisors becomes crucial. When regulations differ, it is our responsibility as supervisors to facilitate cross-border activity without imposing undue operational burdens. The fact that Sam Woods and I are both here tonight may serve as proof that we both take this very seriously.

Let me give you a concrete example: when EU supervisors investigate a bank's internal model to calculate regulatory capital requirements, they could build – for the time being – on the findings of the Prudential Regulatory Authority; likewise, the PRA could build on the verdict of the EU's Single Supervisory Mechanism. For that to be viable, both the PRA and the ECB or the Bundesbank would need detailed information on each other's decisions. We would need a close, responsible cooperation between supervisors.

4. Basel III

Now for something completely different: the finalisation of Basel III – that is the final piece to complete global regulatory reforms after the financial crisis. A globally harmonised standard for all banks would be the welcome result.

Yet one obstacle remains in the way: that of regionally balanced capital requirements. Harmonisation is important, but so is a regionally balanced outcome. However, I am confident that we can find a solution that is acceptable to all Basel Committee members. I just hope that recent opposition to the Basel reforms, voiced by members of the US Congress, are simply

political rhetoric, and that the US remains committed to harmonised standards for global banks. Please rest assured that we remain dedicated to making Basel III a success.

5. Racing to the bottom?

But let me make one thing very clear: focused cooperation and more national autonomy must not be abused as a scapegoat for special interest policies. It must not result in a race to the bottom.

I am deeply troubled by recent efforts to water down post-crisis reforms of financial regulation, whether it is the US presidential decree to cut back Dodd-Frank, the UK's "financial centre strategy", or the European Commission's sometimes overzealous approach to reducing burdens on European banks.

Such policies may seem to be in the best national interest, but ultimately they are special interest politics – the very kind of policies which strengthened populists in the first place. We must expose these policies for what they really are: threats to financial stability.

6. Fostering cooperation

A few years down the road, I very much hope that we will be living in a world in which the close friendships between Britain and Germany, between the European Union and Britain and between the United States and Europe still form the bedrock of international cooperation.

In such a world, we would still be close trading partners and our financial centres would retain their close ties – our supervisors would work together to ensure high regulatory standards, without imposing undue burdens on firms.

Let's not be unrealistic: achieving such cooperation is highly challenging. We need to define the areas in which we want to cooperate, and to what degree we want to cooperate – this will be difficult politics. But it is worth trying to save the post-war order – by developing it further.

We can all further that cause: by finding solutions that respect the legitimate interests of countries wanting increased national autonomy and the need to continue global economic cooperation.

The Bundesbank's representative in London furthers that cause. Ms Julia Becker has done an excellent job over the past two and a half years: she played a vital role in the exchange between the Bundesbank and the Bank of England, and she was instrumental in shaping our Brexit analysis. I am pleased that after a short family break, she will continue to perform an essential role at our Frankfurt headquarters.

I am also confident that Ms Olga Wittchen will continue this successful track record. Coming from our Directorate General for Banking and Financial Supervision, she is an expert in international banking regulation. I have worked with her on several projects on the Financial Stability Board – and I am convinced that she will put her skills towards fostering cooperation between Britain and Germany.

7. Conclusion

Ladies and gentlemen

Henry L Mencken, an influential American writer of the early twentieth century, once said: "For every complex problem there is an answer that is clear, simple, and wrong."

Let's search for answers that are right – and let's expose oversimplified, misleading ideologies – neither nationalist populism nor hyper-globalisation will lead to prosperity and security.

Global economic cooperation has helped us to build a more prosperous society. However, it does have side effects. Only by reducing and managing these side effects can we foster global cooperation in the long term.

Focused global cooperation promises a way forward. We should all put our minds together to decide how this can be best achieved.

Thank you for your attention. Sam: the floor is now yours.

¹ D Rodrik (2000), How far will international economic integration go? in Journal of Economic Perspectives: 14(1): pp 177-186.