I'm not sure the word health is something I would have associated with many economies now, but maybe it is appropriate that we are in Ottawa. When I look around the world and try to find a healthy economy, this one ranks pretty well. I will not get into details. David Dodge can tell us about that. We are going to cover North America with David Dodge, whom you are all familiar with as the former governor of the Bank of Canada. We'll start off with Marty Feldstein, who is always up and never sees the dark side of any silver cloud, and Herminio Blanco from Mexico. Richard Fisher from the Federal Reserve Bank of Dallas will make a few responding comments.

We are talking about North America but, obviously, we are part of the larger world. I think we face the biggest challenge in the larger world of the post-war period. I have never seen, if I may make a preliminary comment, a drop in economic activity quite so rapid as we have had in the last few months in the United States. And for a while we thought the problem in North America and particularly the United States might be moderated by strength in the rest of the world. That hope or expectation has been dashed in recent months. With the exception of Canada, I don't know any other country that isn't in recession in the developed world.

And we have to go the emerging economies, which may be good news in that they are continuing to grow as a whole. If we take China as the bellwether, so to speak, it will be growing all right. Their economy will go from 12 percent last year to six percent or so, which is a bit of a change and will create some problems there. No country is quite as bad as Iceland, which has banks some multiple size of the country. Whether they will survive without bankruptcy is a question.

Every dark cloud does have a silver lining. I, in most of my adult life, have been worried about the supply of Atlantic salmon, and we have moaned and groaned about the scarcity of salmon. I want to report that economic conditions may be bad in Iceland, but they have had the greatest number in recorded history of salmon caught in Icelandic rivers. So it is not all bad news.

But let me say, a lot of the focus, obviously, has been on the financial system. I think the only description for the United States financial system is that it is broken, seriously broken. But underlying the difficulty of the financial system has been a major disequilibrium that has gone on for years, a major imbalance of too much consumption, too little savings in the United States, too many savings in Asia and
China, Japan, and elsewhere. I think underneath this financial crisis, let me just say my own view, is a very serious economic crisis where we have to correct those major imbalances. They are being corrected, and they are being corrected in the most brutal way. In the midst of an economic crisis, U.S. consumption is dropping and dropping sharply.

The point I make is it had to drop sooner or later. It didn't have to drop quite this way, but this is the way it typically happens. We are going to have to have that underlying economic problem corrected. But the good news is, we will come out of this. It may take a little while, but we will come out of this with a better balanced economy, a more competitive economy, and a better balanced international financial system.

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Let me say a couple of things. This is a very complicated situation in the financial markets, and it overlays what David was just emphasizing which I had mentioned earlier, that there is this underlying economic adjustment that has to go on. I hope we handle it reasonably well, which will take fiscal policy and a lot of other things.

But to go back to Jerry Corrigan's comment earlier, we obviously have a confidence problem. Markets operate on trust every day. The trust is evaporating. But what is particularly disturbing is trust in government has also gone. And that is not a new phenomenon. Any survey made on respect for government in the United States shows a very low and declining level of trust. You can illustrate that in financial markets. Currently, the government says it is going to protect securities, such as Fannie Mae and Freddie Mac, which people always assumed it would protect. Yet, those securities now have a risk premium larger than any time in their history after the government explicitly has said they are going to be protected.

It is very difficult to deal with that problem, but I agree with the comment that a change in administration, starting at the election, in the United States may give some hope. I hope it does, but we are not going to cure this immediately. It is very complicated how we got here. We moved from a banking-centered system to a market-centered system. We are in crisis. We are now moving back. I could give you ten reasons why it all happened and needs to be corrected, but let me suggest something simple. Keynes made a comment years ago that all policies reflect the ideas of some scribbler in the past whose ideas somehow became imbedded in the folklore. Let me give you examples.

Compensation practices developed in the last 20 years in an extreme form that rewarded risk-taking. Those practices, with huge rewards, became an article of faith in financial markets and elsewhere. Where did it come from? I'll tell you where it came from in banking and financial markets. Very simply. It came from McKinsey 20 years ago. That renowned institution preached incentive compensation.

Back when I regulated banks and people asked, how do you know when a bank goes wrong, I had
three criteria. It was growing very fast, it was building a fancy new office building, and it had installed an incentive compensation plan.

Then you send in the examiners. What made this so potent was its combination with financial engineering, where you had a bunch of very bright young mathematicians figuring out how to make gold out of floss. In particular instances, it seemed to work. However, the financial engineers didn't contemplate that there would be a general confidence crisis that clogged up all the works. And that is what we had. How did we ever get the degree of leveraging in financial markets that we have over a period of about 20 years? That is not going to be reversed in one year, or two years, or three years, and that is why we have a crisis – so much built up over a period of time.

In any case, I do think this is being unraveled with great difficulty. We essentially have a nationalized a financial market in the United States. Certainly the banking system is nationalized in Europe. It is nationalized in Japan. It was nationalized to start with in China. If that sounds like kind of an exaggeration, after what has gone on this past week or two, it isn't going to be any exaggeration. We are going to have governments taking over banks more explicitly, which we have already done rather implicitly.

Now in Canada, the big commercial banks are going to be at the center of the system. They are going to be heavily regulated. We have a situation in the United States that I never thought I would see where four or five big commercial banks are going to account for half of the market. It wasn't 20 years ago you couldn't even do interstate banking in the United States. This is a tremendous difference. Those institutions are so big, so obviously vulnerable now, they are going to be heavily regulated and, I think, they are going to be prevented from doing a lot of things they have done in the past in hedge funds, the private equity business, and the investment management business.

To oversimplify, we are going to have some big financial institutions to take on in part the nature of a utility for a while. That leaves lots of room for innovation and experimentation and flexibility among thousands and thousands of smaller firms. But I suspect that is the way we are going to end up with a very different vision than the vision of American capital and financial markets that was sold to the world over the past decade. We are going to get there by the sheer weight of the government, which brings me back to the importance of at least a degree of confidence and government itself if this process is going to go smoothly.

I will conclude with these maybe helpful or unhelpful comments. I will tell you a story, if you don't mind. I've been listening to these comments on infrastructure. I was at a breakfast a month or so ago with people moaning about infrastructure. They sounded like David Dodge — all those sewers, bridges, and subways that needed help, and how are we ever going to get financing. All those breakfasts end up inconclusively, and it is time to go to another meeting. We have had our breakfast. Nobody has an answer. But a rather old guy intervened. He said, “I am a professor of civil engineering at a rather important university. I went up to Yale recently. They are giving up their department of civil engineering. So I went
up to Harvard, and they got a couple of old guys there that still teach civil engineering, but the department
doesn't amount to anything.” So what is the result? “You know that new bridge being built over the Potomac
because the old one fell down? I will tell you from my knowledge it cost twice as much to build that bridge
as it would cost in Europe. I don't know how safe it is going to be. We had that bridge in Minnesota fall
down. Besides, we build ugly bridges. If you go to Europe, you go to Asia, you see bridges that look like
architectural masterpieces. Ours are ugly.” And he said that very few elite universities put any weight on
teaching civil engineering. So I sat there and thought that is true. I am very aware of that. So what do we
have? All these universities are producing very few top civil engineers. They are producing thousands of
financial engineers. The result is we have lousy bridges and a lousy financial system.

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