

# Interactive Thematic Dialogue of the UN General Assembly on the World Financial and Economic Crisis and Its Impact on Development

March 27, 2009 (Day 3)

## MORNING SESSION:

### **Jean-Paul Fitoussi (France), Professor of Economics at the Institut d'Etudes Politiques de Paris:**

- The intellectual components of the disastrous social consequences of the financial crisis are one of the largest obstacles of the dominant model and are difficult to remedy.
- *Aggregate Demand:*
  - Excess savings bubbles have been hidden by the “buy the supply” economic strategy, which neglected the damage that it was doing in the labor market.
  - Globalization pays a premium to those who are rich enough to be mobile and take advantage of the weakening stabilization and coordination.
  - A lack of coordination can lead to a rise in protectionism. It is the responsibility of governments to ensure coordination of fiscal stimulus.
- Countries should recapitalize the banking system and help the innocent. Democracy is the only self-correcting institution that we know and it should be utilized to build new capital: human, assets and environmental capital, fighting climate change and paying special attention to the relationship between the long and short term, to facilitate sustainable recovery, especially with regard to the gross debt of a nation.
- *Monetary Policy :*
  - The meaning of national and global economic stability should be redefined, as we look at real stability, price and security of the citizen. Real stability is complex and cannot be summarized by a single statistic.
- *Solidarity:*
  - The belief in superiority of the market has been accompanied by decreased social protection and weakened automatic stabilizers, resulting in a less resilient economy. Social protection is an instrument of social justice and economic stabilization in times of crisis.
- *Symmetry:*
  - Bailouts must be both foreign and national, because the asymmetry of the rich and the poor is costly to the rich as well.
- *Understanding:*
  - We are living in a system which needs to embrace a compromise. The market system based on “a dollar vote” hugely increases inequality. A democratic, person-based vote can help to repair this inequality and save the economy.

**Robert Johnson (US), Former Chief Economist of the US Senate Banking Committee:**

- It is incorrect to say that this crisis was unforeseeable!
- The US consumer has been a buyer of last resort. The incomes in the US did not keep up with productivity, which allowed a large debt accumulation. This system has collapsed and is now groping for sources of demand, which emphasizes coordinated, broad based, fiscal expansion, for high multiplier activity.
- Surplus countries such as China should take the lead and display a constructive role.
- Governments cannot borrow infinitely. This frightens authorities within each country and can be seen in the US where people will be cutting back.
- Lack of regulation represents an intellectual failure to account for negative externalities. It also maximizes the freedom of those in the financial sector and creates moral hazard, as financiers are more likely to take risks, which spillover onto society.
- A regulatory authority would allow for harmonization of standards on issues such as off-shore banking. The Financial Stability Forum has been inadequate. There is a need for input and involvement from those who have been affected to enable proper regulatory authority and avoid the skewed incentives of individual executives. Effective regulation of the credit default swap market should prevent it from being considered as gambling, and creation of fictitious pricing systems.
- It is the moral legitimacy for capitalist democracies to set the rules in the finance domain, rather than money having the ability to purchase and the rules.

**Yu Yongding (China), Director of the Institute of World Economics and Politics, Chinese Academy of Social Sciences:**

- Growth in China has declined from 13% in 2007 to 9% in 2008. However, large stimulus plans aim to increase income expenditure and will be able to offset negative effects. China aims to achieve the target of 8% GDP growth for 2009.
- China has reason to be confident in reaching its target because it is in a good position: The budget deficit has been very low, the banking system is quite good and China has not suffered from a liquidity shortage or credit crunch, which is an important difference. China must use its domestic demand to replace the external demand, which it has been too dependent upon in the past. This will help to contribute to global economic recovery.
- The financial architecture is characterized by the dominance of the US dollar as the single currency has enabled the US to run an enormous current account deficit. It is perverse and unacceptable that the rich borrow endlessly from the poor. These characteristics expose the instability of the system and although the US has ensured no hyperinflation or default, the prospect of dollar devaluation is very scary.
- We must continue trying to reform International Financial Architecture and find ways to decouple debt accumulation from the reserve currency country. The People's Bank of China proposes a new international reserve currency and special drawing rights should be used instead of the dollar, broadening the currency basket to include all major currencies.
- Countries should engage in regional financial collaboration, following initiatives such as the Chiang Mai agreement.

**Dominican Republic:**

- Robert Johnson spoke about poverty and design of corrective measures and packages; could the panel please elaborate on the bailout packages?

**Bangladesh:**

- Will there be distributive implications of the bailouts? What externalities will result from the stimulus packages and to what extent are these externalities being considered, are there comprehensive studies for the knock-on effects?
- An international reserve currency to replace dollar dominated assets should be considered. Will this idea be discussed within the framework of a new global system?

**Pakistan:**

- Our system has failed systemically and is in need of fundamental reform.
- Do you think that the recommendations you have put together will make the fundamental reforms alluded to?

**Brazil:**

- Draws attention to the urgency in implementing regulatory reforms. There is wide debate over whether re-regulation of the financial system should be at national, or international level. The coordination and timing of this should be considered. There could be wide-ranging losses, therefore it is not necessarily best to implement reforms now, perhaps we need more time to debate and analyze.

**Benin:**

- The role of international financial institutions in managing external debt is problematic and allows the poor to be dominated by the rich. Requests more information on reforming debt management to give the poor a chance in the international systems.

**Pedro Paez (Ecuador), Minister for Economic Coordination:**

- The US created the problem, so there is no reason to assume that it should be the Third World that should fall victim to this crisis and have to service debts. With the political will, poorer nations could create a mechanism to restructure third world debt, generating better fiscal conditions and counter-cyclical catch-up for lost time. This would enable countries to achieve the Millennium Development Goals and offset the human cost of lost jobs, if political will.
- Therefore we must create political room for maneuver. A new financial architecture should create a new global reserve system, utilize regional blocs and structures which are culturally appropriate within each of the markets and implement suitable mechanisms for accountability.
- The environment of confidence, reputation, transparency, governance and legitimacy must be reconstructed. Regional settlements have the potential to breathe new life into trade.
- Efforts must be made to restore credit for foreign trade, rather than unsustainable consumption by the North.

**Francois Houtart (Belgium): Special Representative of the President of the General Assembly**

- The “capitalist democracy” is in serious doubt, as it is a system that violates human rights.

- If capitalism is excluding the externalities, then the capitalist logic itself must be discussed and we may need to look beyond capitalism.

**Vietnam:**

- Expressed interested in the need to reform the major currency basket. Asks the commission to comment on China's suggestion and special drawing rights, especially to hear the opinion of Robert Johnson.

**Tanzania:**

- Bank and business bailouts have gained momentum, but should there not be a need for due diligence to establish the institution's viability before bailing it out?

**Saudi Arabia:**

- We must invest soundly in the environment.
- The interests of the world are deeply intertwined and Saudi Arabia has the regulation in place to adapt to this period.
- Reaffirm the importance of international and regional efforts to achieve a favorable climate to face the challenges before them and reiterate their active role in the G20.
- The only way out is transparency in economic transactions: trade must be liberated, with a climate to attract capital. The banking sector has been seriously affected and it is necessary to shore up the banks.

**PANEL:**

**Robert Johnson (US), Former Chief Economist of the US Senate Banking Committee:**

- Equilibrium of the system is dependent upon investors putting their money back in and capital returning to developing countries.
- Voting structures do not enable the conditions imposed to reflect the externalities and as a result the system demands change.
- Geithner's proposals are a move in the positive direction.
- The US has acknowledged some positive steps for reform, including the regulatory reform, which requires common standards at the international level, but implementation must be national with harmonization of national standards across countries.
- It is preferable to get reforms right, rather than be fast, however perpetual delay is also problematic.

**Jean-Paul Fitoussi (France), Professor of Economics at the Institut d'Etudes Politiques de Paris:**

- How can we account for the spontaneous effect of automatic stabilizers and measure the extent of the effort done by each nation.
- We cannot focus on regulation or stimulus packages, we have to do both. We have to begin good regulation now, but it has to be efficient, avoid regulatory arbitrage and new speculation. It is difficult to devise good regulation, this takes time.

- Addressing tax havens will hurt some at first, but overall this is an important aspect of economic reform and we must be radical. We must avoid tax competition and the race to the bottom, new technology should be treated as a real opportunity in the short and long run.
- Is this reform going to help change democracy, or not? There must be a big revolution and we need the right criteria.

**Roberto Bissio - Civil Society Watch:**

- Small economies did not have the courage to tell the rulers what was going on, now we have to look at the mechanisms, with oversight. Institution setting must take place within the UN.
- Women, children and the vulnerable are hit the hardest and we do not have mechanisms available to save them.
- Now we are seeing capital flowing out: a phenomenon we could call “trickle up”, which is rooted in de-regulation. We need protection programs for the poor countries to allow capital controls to protect the poor from protectionism of the richest, with their subsidized banks and stretched provisions.

**China:**

- The lack of regulation and overlooking risk factors are important contributing factors to today's crisis and we must learn from our mistakes and prevent recurrence of the crisis.
- What measures can be taken on the national level and international level?

**Thailand:**

- We should reform early warning systems to react to it in advance and regionally reinforce early warning and surveillance.

**Qatar:**

- Look for efficient and immediate solutions to protect the most vulnerable and guarantee protection of the environment and sustainable development.
- Efforts to achieve the Millennium Development Goals have been slowed down.
- The solutions demand a multilateral response.
- How are we going to use the international reserves for development? Will we introduce a currency other than the dollar as well as reinforcing south-south cooperation?

**Robert Johnson (US), Former Chief Economist of the US Senate Banking Committee:**

- Creditor nations have a stake in the integrity of finance. In the US, although it is democratic, the ‘too big to fail’ institutions have disproportionate political power and excessive influence. There should be a greater role of creditors in the future integrity of the system.

**Yu Yongding (China), Director of the Institute of World Economics and Politics, Chinese Academy of Social Sciences:**

- East Asian financial cooperation on promoting reform of the architecture at global level has met no conflict so far. Asians are disappointed with the IMF and the weakness of the international financial architecture.

- Too much confidence has been put on economists to give early warnings, this is too optimistic as we cannot rely on humans.
- There must be reform of cross-border capital flows.

**Yaga Venugopal Reddy (India), Former Governor of the Reserve Bank of India:**

- Expects the Commission to attend to external debt management.
- We cannot afford to use the existing institutions.
- It is the time to fundamentally examine re-regulation. If we do not, we will return to same mistakes.

**Joseph Stiglitz:**

- Developing countries that have received insufficient attention require large global stimulus, as they do not have resources or policy space that are essential at this juncture.
- Funds must be provided through loans AND grants, we cannot over-burden countries with another debt burden when they are the innocent victims of bad policy. Macroeconomic and regulatory policies must be substantial and provide money directly through a variety of channels.
- We cannot ignore the fact that IMF has often pursued pro-cyclical policies. This legacy will not be wiped out overnight and there is a confidence issue, where countries are reluctant to turn to the IMF for assistance until it's too late.
- To avoid delay regional institutions should be utilized and endorse the creation of new credit facility.
- We need to reform old institutions as well as creating the new ones. We can make use of existing institutions resources to take immediate action.
- There must be stronger regulation, there is real risk of cosmetic reform as opposed to real reform, political and economic that leads to real reform. Financial markets are very clever at creating complex products and institutions that appear to regulate when they are not. Comprehensive oversight is important but it is not enough.
- Shadow-banking entails greater risk to the economy and we need a Financial Product Safety Commission to be created, one which will do what it says it will do. The existing institutions have not produced core functions they were supposed to.
- There must be oversight and regulation, including for derivatives, regulation of competition, credit rating agencies. Incentives are one of the deep problems, as people undertake excessive risk, but existing incentive structures have not even served shareholders well.
- In the interest of all countries there must be these debtor and creditor markets, which go beyond one country, reaching out to global action, as global instability is not desirable for anyone.
- *New Global Reserve System*
  - Keynes hoped for creation of a new global reserve system, but this was vetoed by the US. Global instability hurts all, it is a common concern and there is broad consensus that we need alternative institutional arrangements. This can be done through non-inflationary contributions to global stability and transition which enhance stability of the global economic system through a top down or bottom up regional approach.
  - If it is not done, there will be ad-hoc reforms made regionally from bottom up, which lack control over how reforms are shaped.

- Therefore the Commission will take a pro-active role in leading these efforts for reform.
  - The global economy is interdependent and needs coordination, at the moment it lacks overall perspective of what is going on. Reform must take place within the international financial institutions, governments and accountability to finance ministers and central banks.
- Coordination with environmental issues is also important and gaps in the global economic architecture must be identified and systems for bankruptcy, defaults and sovereign debt restructure created accordingly.
- The preliminary report lays out the framework to guide forward thinking.
- We must not wait for the economy to recover, otherwise momentum for reform will be forgotten and we will return to the way things were.
- This time it is a crisis that began in centre and has spread to the periphery. We are at a moment to change the way that the economy works and we can draw upon historical experience and previous commissions.