A new Path for World Development

Concerted Strategies to meet the Environmental and Economic Challenges of the 21st Century

National Bank of Austria, Vienna

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Governeur Prof. Ewald Nowotny

Opening Statement (10 Minuten)

Thursday 16th April, 9 bis 10 Uhr

It is a great pleasure to welcome you here in Vienna on the occasion of the "Club of Rome" conference. The topic of this conference – "Concerted Strategies to meet the Environmental and Economic Challenges of the 21st Century" – has never been more pressing than today. We are experiencing the biggest economic and financial crisis since the Great Depression. In the developed world the economic outlooks have been repeatedly revised downwards. In 2009, for the first time in decades, the volume of world trade is projected to decline. Unemployment rates are surging. The outbreak of the financial crisis originated in the advanced developed countries, but has spread quickly to emerging economies and to developing countries. The UNESCO has recently warned us that the financial crisis will touch the lives of the world's most vulnerable, pushing millions into deeper poverty and leading to the deaths of thousands of children. According to the International Labor Organization every 1 percent fall in growth in developing economies will translate into an additional 20 million people consigned to poverty.

While there are some similarities to the Great Depression, in particular with respect to the worldwide nature of the economic decline, one major difference is the quite diverse policy response. Policymakers have learned from that episode and have reacted with timely and – to some extent - unusual measures. Central banks across the world have reduced interest rates, provided the banks with liquidity and some of them have engaged in quantitative easing. They started to directly purchase financial assets from the private sector and/or from the government or to allow these assets as collateral when lending to the banks. Furthermore, financial rescue schemes have been set up to stabilize the banking sector. In addition, substantial fiscal stimulus packages were designed to offset the shortfall of global aggregate demand. In parallel, the G20 started a process of better coordinating economic policies and overhauling the regulatory framework for financial markets. There is some hope that the pace of deterioration will slow and, perhaps, that activity will pick up later in the year as a result of the various stimulus measures.

It should be clear to all of us that without the countercyclical fiscal and monetary policy measures the large global imbalances would disorderly unwind and would severely aggravate the crisis with the risks of debt-deflation and mass unemployment. These risks have to be weighed carefully against the risks involved with rising public debt when discussing the appropriateness of fiscal stimuli packages. The fiscal stimuli might also help to stabilize the banking system and reduce potential further writedowns in the credit portfolio resulting from corporate defaults. In Europe, the size and generosity of its welfare states are cushioning the impact of the economic slump. But let me mention at this occasion that Europe, and in particular the surplus countries, might need greater fiscal stimulus despite more extensive automatic stabilizers than in the U.S. Otherwise an early rebound in economic activity might be endangered.

Overall - on a global scale - the immediate crisis response to revive growth and employment was timely and substantial. But some maintain that this must be combined with building the foundations for the modern economies of the 21st century, by investing in transport infrastructure, renewable energy education, research and development as well as in social infrastructure, such as health care, unemployment insurance and poverty alleviation. In starker terms, it is a question of reviving the status quo ante or transforming our socio-economic systems fit for the future. The latter however requires the same kind of bold initiative as undertaken by Roosevelt's New Deal in the 1930s, but at the global scale and embracing a wider vision. An expanded vision is critical to the lasting success of a world economic recovery.

There are few episodes in history when a crisis could be successfully converted into opportunity. In light of rising unemployment, impoverishment and political risks associated with the crisis, it might be regarded as cynical to link the crisis with opportunities. But the world's severe economic downturn must be addressed alongside and not to the exclusion of other problems – I will mention here: the lack of accountable global governance, climate change and global inequality.

Among the many opportunities that I see let me single out a few points. First, as an economist, I strongly believe that ***green investment is one solution for two crisis***. The financial and economic crisis seems to push the issue of climate change to the back of our minds. The G-20 summit in London by early April was rather silent with respect to ecoological obligations. The financial crisis is often used as an excuse to break climate change commitments. Last December the United Nations Secretary General Ban Ki-Moon called for a new 'Green New Deal' to kick start the global economy. UN talks on a post-Kyoto climate deal end in December of this year in Copenhagen and agreement is crucial if limits on CO2 emissions are to be achieved, not only for the sake of climate change, but also for energy security.

Currently, governments worldwide are proposing and implementing 5 trillion US Dollars in additional spending over the next three years to revive the world economy. Today, to many it seems that the resources for all the measures required to let the vision of a sustainable development become real, are in danger of being crowded out by these numbers. But a recent study has shown that many countries are already now allocating a sizeable proportion of their fiscal stimulus packages to investments in low-carbon economy. The United States and China are well ahead of Europe both in terms of the size and the green dimension of their stimuli. China is dedicating 40% of the package to rail, grids and water infrastructure, along with dedicated spending on environmental improvement. South Korea allocated more than 80% to the environment. With 12% the green component in the United States is smaller than China's, but it is more broadly based, and the only plan with a real boost to renewables. In Europe, France and Germany are devoting 20% and 13% of their stimulus packages to the environment, with a strong focus on low-carbon investment. In many countries the fiscal packages could be better targeted and used to stimulate the new, renewable-energy growth sector and help to initiate a technological revolution which creates sustainable growth now and in the future. It's a question of employment, efficiency and forward thinking, and – most importantly – an issue of comparative technological advantage. And it combines the urgent with the important.

This brings me to my second point. The crisis has uncovered the weaknesses of the current international financial architecture. There is now the chance to ***build global accountable institutions***. The impressive attempts of last months of major countries to work together show that hardcore globalisation can force global government action. Whether history books will mark the financial crisis as the start of building a 21st-century global-governance system is still to be seen. The London G-20 Summit and the Washington Summit last autumn can be regarded as important starting points in this direction. To replace the Financial Stability Forum with an enlarged Financial Stability Board to work with the IMF to provide early warning of macroeconomic and financial risk and reshape regulatory systems is highly welcome. But in the medium term, the process of globalisation of politics has to become more inclusive. Still, the poorest countries containing one third of the world population and the most vulnerable to a crisis to which they had not contributed, are missing in this process. Global governance needs global representation.

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Finally I would to reflect upon the ***perspective of the economics profession***: Today I am a central banker. But for some decades I used to be an economics professor at the university. In that position I witnessed how the ideas of efficient markets and rational investors have become so dominant in academics, but also in government and markets. Both were soon found in every major textbook, and both were important parts in most of the New Classical and New Keynesian macroeconomics. The influence of alternative approaches was, however, strictly limited. Some observers even argue that research tended to be motivated by the internal logic of self-referential epistemic communities and by esthetic puzzles of established research programmes rather than by a powerful desire to understand how the economy works. Economists undoubtedly bear some responsibility for the crisis. The global move towards the anglo-saxon self-regulatory model of financial regulation was forcefully advanced by politics – at the recommendation of efficient market financial economists.

If we think about economic strategies to prevent future financial crisis and to safeguard sustainable economic development it is crucial to question the fundamental principles of economics. Economic theory and in particular finance theory and practice have become increasingly disentangled. Economics today is a discipline that must undergo a paradigm shift. It must broaden its horizons to recognise the insights of other social sciences and it must return to its roots. Smith, Keynes, Hayek, Robinson, Schumpeter, Minsky, Galbraith and all the other truly great economists were interested in economic reality. Their insights came from historical knowledge, psychological intuition and political understanding. They persuaded with their deep comprehension of the nexus between politics, society and economics, and their strength of mind, not just with formal logic – which is undoubtedly an important methodological tool in economics. Some of them were even bold enough to sweep an old paradigm away.

Thomas Kuhn, the influential historian of science, argued that academic establishments fight hard to resist such paradigm shifts, but I am afraid, and herewith I conclude, resistance to change is a luxury we cannot afford this time.

Academic establishments fight hard to resist such paradigm shifts, as Thomas Kuhn, the historian of science who coined the phrase in the 1960s, demonstrated. Such a shift will not be easy, despite the obvious failure of academic economics. But economists now face a clear choice: embrace new ideas or give back your public funding and your Nobel prizes, along with the bankers' bonuses you justified and inspired.

Ende: G20 was a big Step forward, what is lacking: a comprehensive

G20
http://www.guardian.co.uk/commentisfree/cifamerica/2009/apr/02/g20-agreement-imf-tax-havens

Ladies and Gentlemen!

There is now a rare moment in history that crisis can be converted into opportunity.

http://www.nakedcapitalism.com/2009/04/china-out-to-dominate-in-electric-cars.html
http://www.guardian.co.uk/environment/2009/feb/24/obama-environment-economic-rescue/print

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http://globaldashboard.org/wp-content/uploads/2009/HSBC_Green_New_Deal.pdf

http://www.euractiv.com/en/climate-change/eu-lagging-competitors-green-stimulus/article-181093

http://www.unep.org/greeneconomy/docs/GGND_Executive_Summary.pdf

Focus on the G20
RGE Monitor
Nouriel Roubini
April 1, 2009

Leaders of the G20, the advanced and emerging economies that account for 80% of global output, will meet in London later this week to plan further coordinated responses to the financial crisis and global recession. This meeting, the second involving the heads of state of these countries following one in Washington last fall, underscores the growing importance of emerging markets. Although there is increasing consensus on reducing the toxic assets on bank balance sheets improved financial regulation, and boosting the resources of international financial institutions like the IMF, the members remain divided on additional fiscal stimulus. Meanwhile the economic outlook remains bleak.

The EU's common strategy, released March 20, focuses on regulating hedge funds, private equity, credit derivatives and credit rating agencies, and vowed to crack down on tax havens ("non-transparent jurisdictions"). And the U.S. is basically on the same page with Treasury Secretary Geithner calling for a systemic risk regulator, and promoting a system of regulation by activity rather than by institution, thus encompassing all institutions trading in financial derivatives and hedge funds and major insurers such as AIG. Meanwhile, the ECB has recently signaled for the first time that it will follow suit with other major central banks that have already engaged in Credit or Quantitative Easing to various degrees.

According to press reports, the G20 also plans to issue a set of guidelines for countries to use to rid banks of toxic assets. The ECB is said to be working on guidelines for governments that plan to guarantee toxic assets remaining on banks' books, whereas the European Commission prefers a solution where toxic assets are written off at market value, and where any write-offs will first have to come out of shareholders' capital. Once the capital falls below the Basel ceilings, it is up to the government to provide new capital, or to force the bank into bankruptcy procedures. In the U.S. Treasury Secretary Timothy Geithner unveiled the center piece of the U.S. Financial Stability Plan consisting of 1) 'stress tests' and capital assistance; 2) Public Private Partnership Investment Program (PPPIP) to price and remove toxic assets from the banking system; 3) the expansion of the Term Asset-Backed Lending Facility (TALF) to support the securitization market next to the homeowner affordability and loan modification plan.

The EU's common strategy does not include a call for an increased fiscal stimulus given that the current size of the EU's overall fiscal effort, including the additional effect of automatic stabilizers, of around 3.3% of EU GDP, or over €400 billion, and concerns about the medium-term fiscal sustainability criteria of the Stability and Growth Pact. Individual EU leaders such as Gordon Brown, have nevertheless signaled that they might consider further fiscal stimulus packages as warranted in their countries. The IMF has been pushing the G-20 countries to step-up their stimulus spending. Deficit countries such as the U.S. and UK support the idea of global stimulus given the severe recession and job losses, and to prevent import leakages through their own stimulus packages. However, surplus countries like Germany, France, Sweden and many others in Europe remain wary given the impact on rising fiscal deficits, government debt and inflation at a time when massive U.S. debt issuance may crowd out debt issuance by other countries with implications for the exchange rate as well.

Going forward, bank bailouts and stimulus spending will raise pressure on budget balance and government debt when tax revenues especially from corporate incomes, dividends and capital gains are slowing significantly and Western countries face high health care and entitlement burden due to ageing populations. According to the IMF, G-20's government balance will deteriorate by 3.5% of GDP in 2009. Developed countries' deficit will rise to 7% of GDP in 2009 from less than 2% in 2007 and their gross debt-to-GDP ratio will rise by 15-20%. Emerging markets will move from a fiscal surplus in 2007 to a deficit of 3% of GDP in 2009. There are also suggestions that stimulus spending should be undertaken by surplus countries like Finland, Sweden, Luxembourg, New Zealand, Australia, China, Germany while deficit countries such as the U.S., UK and Italy should increase savings rates as part of the re-adjustment. Oil exporting economies, especially in the Gulf, perhaps no longer surplus countries, are by and large continuing with their expansionary fiscal policy by drawing on past savings.

Several G-20 countries have already been implementing fiscal stimulus packages which the IMF estimates amount to 0.5% of GDP in 2008, 1.5% of GDP in 2009 and 1.25% of GDP in 2010 with one-third in revenue measures and two-thirds in expenditure measures, and mostly accounted by U.S., China and Japan. As the growth contraction in EU will be much worse than in the U.S., Europe might need greater fiscal stimulus despite more extensive automatic stabilizers than in the U.S. The impact of stimulus on growth depends on its size, multiplier effects in individual countries and time lags in implementation, and might be constrained by credit freeze in the economy. Measures undertaken so far indicate that they will fall short of the extent of contraction in global growth and private demand and job losses. Another risk is that it might be difficult for many countries to scale back the stimulus once the recovery begins, creating the risk of inflation and also difficulty of rolling back politically appealing tax cuts.

Going forward, while many countries might remain averse to a coordinated global stimulus, they will individually continue to dole out stimulus packages as economic conditions and job losses worsen. Nonetheless, given forecasts for global growth contraction and job losses during 2009-10, stimulus measures are needed in the form of unemployment benefits, social safety nets, food stamps, worker retraining and education programs, tax cuts for low income households and unemployed - though their size might depend on the individual countries' fiscal space.

While the G-20 countries have consistently pledged in the past to prevent reverting to import barriers, financial and labor protectionism, and such a pledge is likely to figure significantly in this week's communiqué, these forms of protectionism have in fact grown since the beginning of the crisis in late-2008 as the global economic and employment outlook. Many countries have been raising tariff and non-tariff barriers, providing export subsidies, bailing out domestic firms and auto companies over national ones, instilling protectionist clauses in fiscal stimulus packages to encourage spending only on domestically produced goods and hiring of nationals. These measures will exacerbate the expected contraction in global trade and global excess capacity and deflationary pressures, increase global trade distortions, reduce effectiveness of global stimulus packages, reverse past gains from free trade and migration while having limited short-term impact on growth. Capital withdrawal by foreign banks especially from emerging markets and pressure by Western governments on banks to increase lending in domestic economy –are raising the risk of financial protectionism which during the current crisis will have a greater impact on growth especially for countries that were highly dependent on foreign capital to drive domestic growth

But in spite of further pledges at the G-20 and concerns voiced by many developing countries about this, these instances of protectionism and also competitive currency devaluation by some countries will prevail in the coming months as governments face political pressure at home amid credit crunch, export fall and large job losses. Countries can manage to raise tariffs without violating the WTO bound rates and there is no binding international organization to curtail labor or financial protectionism. Nonetheless, many countries increasingly also realize that in an intertwined global economy, protectionist measures by one country will lead to retaliation and therefore greater adverse impact on growth and employment.

Another thing on which the G20 members do agree on is about boosting the IMF's financial firepower and that of regional development banks to increase their ability to lend to emerging economies IMF's executive board recently approved a major overhaul of the IMF's lending framework, including the creation of a new Flexible Credit Line (FCL). The IMF's new framework includes new credit lines for strong-performing economies that need insurance and tailors loan terms to countries' varying strengths and circumstances. Additionally, the fund intends to modernize conditionality, adding more flexibility to credit lines, enhancing stand-by arrangements, doubling lending access limits, simplifying cost and maturity structures, simplifying lending toolkit, and reforming facilities for low-income countries. The changes follow many years of low demand for IMF assistance, contributing to its own budget woes.

Several of Emerging Europe's fast-growing economies have already turned to the IMF and

EU for financial assistance. Most of those nations are suffering from sharply slowing economic growth, tough external financing conditions, elevated risk aversion and tense liquidity situation. In recent months, the IMF has committed roughly $48 billion to a variety of battered emerging economies, including Belarus, Latvia, Pakistan, Iceland, Ukraine, Hungary and Serbia. EU leaders called for IMF resources to be doubled to $500 billion to help head off new problems in countries already hit hard by the global economic and financial crisis. The U.S. has called for tripling the IMF's lending capacity but getting permission for its own contribution (possibly an additional $100 billion) may face a tough congressional battle. While some analysts believe the EU does not have sufficient resources to save Eastern European countries without the IMF help, the fund could have as much as $443 billion available when the recent loan from Japan is taken into account, comparable to street estimates of Eastern Europe's needs to cover loans and prop up the credit system. But will the channeling of funds reduce the vulnerability of those emerging European nations?

Asian countries like China, Japan, South Korea, India, Taiwan, Singapore and Hong Kong who hold more than $4 trillion in foreign exchange reserves - much of it in U.S. dollars are in a much better position. Asia's surplus position could be the ultimate source of capital to bail out the financial system, say by providing funds to the IMF to avoid further export contraction. Japan has already provided capital and China is reportedly considering a $40 billion contribution. However, China and other emerging economies would likely demand governance reforms, including rebalancing the institution's voting power, likely at the expense of some European countries. In fact China comes to the G20 table with a set of suggestions about international financial reforms – most significantly, the central bank governor's recent calls that the Special Drawing Right (SDR) might overtime supplant the US dollar as a reserve currency to avoid the instabilities of the current system. Elevating the SDR several key preconditions though including increasing flexibility of the RMB. China has been extending swap lines to emerging and frontier economies including Indonesia, Belarus and most recently Argentina, perhaps providing an alternative or complement to IMF funding for such economies.

In Latin America, the external funding situation remains relatively stable but in the case of further deterioration of capital flows, the solid economies would be able to tap the IMF or the Inter-American Development Bank (IADB) for non-conditional lines of credit, while the economies with less sound macroeconomic frameworks such as Ecuador, Argentina and Venezuela would most likely only be able to obtain funds through more formal conditionality or by turning to lenders like China.

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Let me make a few remarks on the issue of climate change. Almost forty year ago, the Club of Rome raised considerable public attention with its report *Limits to Growth*. The study challenged one of the then core assumptions of economic theory – that the Earth was infinite and would always provide the resources needed for human prosperity. The report concluded that we could not continuously consume vast amounts of resources forever, an issue which was only recently put on the table again, with the publication of the Stern report and the studies from the United Nations calling for urgent action.

Furthermore, rich countries tend to use the current crisis as an excuse to turn their back on the world's poor.

The European Union's structural-funds model, based on EU co-funding of up to 80%, can be used to disburse the EU's new energy-stimulation package, making it attractive also for east-central European member-states to join the new energy revolution.

http://www.opendemocracy.net/article/the-global-financial-crisis-opportunities-for-change