''Re-regulating Global Finance in the Light of the Global Crisis''
organised by
International Development Economics Associates (IDEAs),
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Conference Report

April 9: Session 1- Welcome

The conference started with a welcome by **Jayati Ghosh** (Executive Secretary, IDEAs)**. Wu Dong** (School of Economics and Management, Tsinghua University) argued that although the crisis originated in the US, it has significantly affected all developing countries. Therefore there is a need to examine the root cause of the crisis and find solutions, and so conferences like this one play an important role. **Leonardo Burlamaqui** (Ford Foundation) argued that finance should be treated differently from other segments of the economy. He noted that the self interest of people is not enough to ensure stability, and therefore the system should be guided by public interest. He argued that the crisis has presented some pressing questions that need to be addressed. First, there is substantial divergence of opinion on the "root" causes. Second, there is disagreement on appropriate policies—liquidity infusion, capitalisation and fiscal stimulus. Third, there is disagreement on the nature of financial regulation. Fourth, there is a problem presented by the global nature of markets and national character of existing regulation. Finally, there is no clarity on what kind of incentives needs to be put in place for regulators. **John Samuel** (Action Aid) argued that the root cause of the present crisis is the neoliberal economic order. The crisis will put poor people at the receiving end of the power structure. He argued that the need of the hour is to challenge the unjust neoliberal order, and therefore re-regulation has to be a reconfiguration of politics and power relations within and between countries.

April 9: Session 2- The Crisis and the Regulatory Challenge

In his presentation, **Jan Kregel** (Levy Economics Institute of Bard College) argued that the US Federal Reserve's diagnosis of the current crisis is similar to Fisher's diagnosis of the Great Depression, and Bernanke's and Krugman's diagnosis of the Japanese economic crisis of the nineties. In these interpretations, the crisis can be resolved through reflation of goods and asset prices by means of an expansion in the money supply. The Roosevelt administration responded to the Great Depression through open market purchase of Treasury securities. While open market operations were successful in augmenting bank reserves, they failed to produce expansion in money supply. Moreover, the expansionary policy had to be withdrawn shortly after its introduction in 1932 as banks' profits were squeezed due to the reduction in interest rates on Treasury securities. In addition to monetary easing, other policies

directly aimed at increasing prices such as currency depreciation, the Agricultural Adjustment Act and the National Industrial Recovery Act were introduced. The idea was to increase prices to their pre-crisis levels so that debtors could meet their commitments. Similar policies of monetary expansion were used during the nineties by the Bank of Japan, which reduced its policy rate to zero and indulged in quantitative easing in the hope that prices would rise sufficiently to reduce real interest rates and revive the economy. At the suggestion of Ben Bernanke, currency depreciation was also tried by the Bank to increase prices. These measures, however, turned to be ineffective as bank lending failed to pick up in spite of increase in bank reserves. According to Kregel, these prescriptions of reviving the economy through monetary easing have failed because they are based on a wrong understanding of how the banking system functions. He argued that reserves are endogenous to the system: banks first make loans and then try to obtain reserves to fund these loans. A crisis occurs when banks cannot cover this short position in liquidity. He argued that Central Banks should commit to provide liquidity to all financial institutions, so as to support asset prices and avert deep financial crisis. In the current crisis, the Fed's response was both late and hesitant. He argued that the main role of the Central Bank should be to ensure financial stability, whereas the goal of managing demand and price level is better handled with fiscal tools. The idea of boosting prices through monetary easing is completely misplaced and will not work.

In the same session, **C.P. Chandrasekhar** (Jawaharlal Nehru University) argued that the crisis originated in the mortgage periphery of the financial system but quickly spread to the core of the banking system, which was affected by the mortgage crisis because it carried some of these doubtful assets in inventory. Also, banks had set up their own special purpose vehicles to acquire such assets, and had lent to institutions that used leverage to acquire these assets. Since banks are at the heart of the payments system and are also the principal carriers of risk, governments across the globe have adopted measures to prevent large-scale bank failures. These attempts have included provision of refinance against toxic assets, guaranteeing deposits and investment in preference capital of banks. But as these attempts failed to salvage the system, governments in various countries are now being forced to nationalize their leading banks by buying into their common equity. **Chandrasekhar** argued that the Anglo-Saxon system of financial markets that leads to systemic failure and crisis was an outcome of the dismantling of the controls and regulations that were instituted after the Great Depression. Since regulations reduced the overall rate of return in the banking sector, they were in conflict with the fact that banks were privately owned. This led to a deep contradiction in the privately owned regulated banking system. This inner contradiction was aggravated by high inflation since the mid-1960s, leading to intense pressure for deregulation of the banking sector. The deregulation that has since ensued has led to the financial crisis. **Chandrasekhar** argued that since a regime of privately owned regulated banking system will always face inner contradictions that will ultimately create pressure for deregulation, some form of public ownership of the banking system is inevitable. **Chandrasekhar** also

emphasized that in addition to ensuring stability, publicly owned banks can be used as instruments for ensuring broad-based and equitable growth.

In his discussion of these papers, **Dic Lo** argued that the crisis of the financial system is indicative of a deeper real problem of profitability. Financialisation was used to overcome this problem but has resulted in speculation and crowding out of productive investment. Dic Lo drew attention to the East Asian financial systems that were publicly owned and directed resources for productive investment. After the East Asian crisis, it was argued that such systems suffer from crony capitalism and poor allocative efficiency. Free market financial systems have their own share of problems. If finance pursues its own objective freely, it crowds out productive investment. He thus emphasized the need to shape the financial system according to the requirements of real economy and development.

Prabhat Patnaik (Jawaharlal Nehru University) referring to Kregel's distinction between Keynes and Fisher, argued that all measures of reflating prices are also measures of increasing activity, so that the distinction between Fisher and Keynes is not so obvious. **Jayati Ghosh** pointed to the dilemmas faced by lenders of last resort in the current situation, with rampant moral hazard as well as the difficulties of anticipating the implications of allowing any particular institution to fail. **Noemi Levy** noted the need for saving non-bank financial institutions. **Yilmaz Akyuz** argued that Minsky was complacent about asset price bubbles because he believed that a big bank and a big government can always intervene to avert the deepening of the crisis. Many participants discussed the need to repair household balance sheets to overcome the crisis. The need for public banking was also stressed.

In his response, **Jan Kregel** noted that the current plans of reflating prices have relied on monetary intervention and have more or less ignored direct spending. He argued that it is important to save non-bank institutions, because otherwise the crisis will spread to the core of the banking system. In the longer run, however, stronger regulation of these non-bank entities should be attempted. He pointed out that Minsky believed that government intervention to save the financial system through big bank and big government sets the stage for a deeper crisis in future. **C.P. Chandrasekhar** reiterated that public banking aligns the incentives of state and banks. He argued that the failing banks need to be saved which in the current context that may require use of taxpayers' money. This is bound to invite political opposition since it leads to socialisation of risk whereas profits remain private. This conflict can be solved if banks themselves are forced to become public.

April 9: Session 3- Stabilising the International Financial System

Prabhat Patnaik argued that any recession is, by definition, a situation of excessive liquidity preference. It is a situation in which demand for money at the prevailing interest rate is infinitely elastic. In the current situation, such excessive liquidity preference is limited not just to the public but is also affecting banks. If "high-

powered" money is directly injected into the banks and other financial institutions, then it is simply held by these institutions without causing any increase in the money supply to the public. Recovery from the crisis will require resolution of this liquidity trap. One resolution could be monetarist, involving a fall in prices. However, since money is also a form of holding wealth, any fall in prices, if it generates expectations of further fall, will only increase its demand. Also, a fall in prices will increase the real burden of debt, thereby leading to forced sale of goods that only makes recession worse. Another way of solving the crisis could be a currency tax similar to the one proposed by Silvio Gesell. But such a scheme cannot be successfully applied to other forms of money. A third way out of the crisis, which the US administration is currently trying, is the purchase of toxic assets from private financial institutions and their recapitalization. This bailout of private financial institutions will allow banks to get out of their liquidity trap but will not necessarily get the public out of its liquidity trap. Patnaik argued that direct spending by government is a more effective antidote to recession than the bank rescue plans being implemented in the US.

In his presentation, **Yilmaz Akyuz** (formerly UNCTAD) raised three issues for reform. The first is the issue of multilateral discipline in macroeconomic and exchange rate policies to secure stable exchange rates and payments. The second relates to the use of a domestic currency as an international reserve, which contributes to the instability of the system. The third is the nature of regulation and supervision of the international financial system. **Akyuz** highlighted that the IMF has never exerted discipline over its non-borrowing members. Lack of multilateral discipline over the policies of rich countries, especially the US, has contributed to the instability of the global financial system. He thus highlighted the need for multilateral discipline on macroeconomic policies of all countries. He also proposed an alternative system of international reserves based on SDRs. Since financial crises have global spillovers, regulation should be international. Also such international regulation will check regulatory arbitrage. However, a full-fledged multilateral system of financial regulation is likely to face hurdles since individual countries may not be willing to give up their autonomy. Moreover, "one size fits all" regulations may hurt the developing countries more, especially if they are required to give concessions in the form of free capital mobility and greater market access for financial services. Akyuz highlighted the need to check the procyclical behaviour of international lenders to LDCs and regulate rating agencies. He also argued that developing countries should have the right to control both inflows and outflows of capital.

Commenting on these papers, **Michael Pettis** argued that the US current account deficit supported domestic activity as well as activity in export-oriented economies like China. Currently, the process of adjustment is taking place. Consumption demand in the US is falling as households reduce their debt. Export-oriented countries will be left with surplus capacity that can be utilised only if they increase domestic consumption. Historically, the shift from export orientation to domestic consumption has been painful and difficult to achieve: for example, in the US during the Great Depression, this adjustment was brought about by closing down factories and reducing domestic capacity. Additionally, any domestic expansion will have to

confront the issue of lack of global co-ordination. Some countries may try to free ride on the fiscal stimulus of other countries. Clearly, such concerns regarding leakage of benefits from domestic fiscal stimulus may make such stimulus less attractive from the point of view of individual countries.

Terry McKinley pointed out the significance of the nature of fiscal stimulus—its composition in terms of investment and consumption. **Jayati Ghosh** questioned the feasibility of using SDRs as international reserves. She argued that money reflects power and the dollar derived its status of international reserve currency from the domination of the US in international affairs. Many participants argued that China should look to raise domestic consumption and undertake expansionary fiscal policies. It was also noted that lack of co-ordination may act as a constraint on expansionary fiscal policy. In his response, Prabhat Patnaik agreed that that there is a need to co-ordinate fiscal expansion. In support of his proposal for using SDR as international reserve, **Yilmaz Akyuz** argued that holding SDRs entails no cost and the cost is incurred only when SDRs are used. He also argued against WTO-style structures of regulation of the international financial system. Michael Pettis argued that China's fiscal expansion may not solve the problem of trade imbalances, pointing out that China's trade surplus has in fact increased after fiscal expansion.

April 9: Session 4 - Finance and the Real Economy

Jayati Ghosh (Jawaharlal Nehru University and Executive Secretary, IDEAs) spoke on the food crisis. She argued that the fall in world food prices has mistakenly been perceived by many as the end of the food crisis. Such complacency is completely unwarranted as large parts of Third World are still facing the food crisis. She showed that world trade prices of both food and cash crops peaked in the summer of 2008 and have fallen drastically since then. The sharp volatility in food prices observed in the recent past cannot be explained by underlying demand and supply conditions. Contrary to the belief that China and India may have been responsible for the increase in prices till mid-2008, she pointed out that food consumption in these countries has in fact fallen. She ascribed the acute price movements to speculative activity in commodity markets that gathered pace after deregulation of commodity trading in 2000. After the financial market downturn that started in mid-2007, speculative investments were shifted to commodity markets, leading to sharp increases in prices of crucial commodities. These positions in commodity markets were liquidated by speculators in mid-2008 to cover mounting losses in financial markets. This resulted in sharp declines in food prices after mid-2008. Both cultivators and consumers suffered due to extreme price volatility. Moreover, while increase in prices was passed through to the consumers, the subsequent decline was not passed through. This was because either the currencies of major developing countries have depreciated due to the crisis leading to higher domestic prices of imported food or fiscal and balance of payments constraints prevented the required food provision. Ghosh concluded that developing countries need to secure food

supplies either through domestic production of food or other arrangements, in order to insulate their economies from such volatility.

In his presentation, **Saul Keifman** (University of Buenos Aires) noted that financial liberalisation has led to repeated financial crisis in developing countries. Developing countries' financial problems came to the fore with the debt default by Latin American countries following large-scale borrowings by military dictatorships in these regions and continued into the nineties with the Tequila crisis in Mexico, the East Asian crisis and crises in Russia, Turkey etc. Rich countries and multilateral institutions placed the blame for the crisis on developing countries, and forced them to undergo greater financial liberalisation. At the same time deregulation continued unabated in the developed world leading to repeated financial crises (the 1987 stock market crash, the fall of Long Term Capital Management, the burst of internet stocks and the sub-prime crisis). **Keifman** argued that the root of the problem is the speculative behaviour of investors as elucidated by Keynes. He stressed that the crisis has presented an opportunity for developing countries to discuss with developed countries how to restructure the international economic order. However, for developing countries to raise their issues, what is required is a democratic global polity. The current Bretton Woods institutions, with their plutocratic and oligarchic governance structures, are a far cry from a democratic global polity. What is required is a thorough reform of international institutions, starting with the UN itself, so as to make them more participatory. Keifman also argued that the agenda of better regulation of financial system is not the agenda of developing countries that face the more pressing question of obtaining finance for development. He argued that there is a need is to end financial globalisation and increase availability of finance for developing countries.

Juan Carlos Moreno (CEPAL, Mexico) discussing the two papers argued that the food crisis is going to make recovery from the financial crisis even more difficult for developing countries. He drew attention to the issue of migration. He argued that with loss of employment in developed countries, people are returning to developing countries. This is likely to cause a fall in remittances and shrink the resources available to developing countries for development. He also made the distinction between food self-sufficiency and overall food security of the population, and pointed to the need for food subsidy and other measures to improve overall food security. He also emphasized that in the current conjuncture, the policy agenda cannot be limited to re-regulating finance; rather it has to be a more comprehensive agenda for reforming the world economy.

In the discussion, **Harry Shutt** noted that the crisis of food is the crisis of economic liberalisation which views agriculture as a business like any other. **Arturo O'Connell** argued that there is a need to take a longer term view of trends in agricultural prices. The prices at their peak in 2008 were comparable with their levels in the mid-sixties after which they remained depressed for decades. **Noemi Levy** drew attention to the promotion of bio-fuels that has aggravated the food crisis. Another issue that was debated was the proposal for a regional IMF. While **Martin Khor**

stressed the need for such regional financing institutions to avoid strong conditionality attached with IMF loans, **Arturo O'Connell** called into question the feasibility of such regional IMFs since developing countries are often hit together and require financing at the same time. In her response, **Jayati Ghosh** agreed that migration is an important issue. She also agreed that the decline in development finance has also worsened the situation. She argued that use of bio-fuels is not necessarily environmentally more sustainable since bio-fuels require mechanised cultivation. In general, she argued that no country can choose to ignore food production. Responding to the discussion, **Saul Keifman** reiterated the need for increasing finance for development. He also supported the idea of regional monetary co-operation. In particular, he argued that the current crisis is not the crisis of lack of regulation but that of a failed model of development.

April 9: Session 5- Public Panel on Policy Directions

Jan Kregel started the discussion by arguing that a global stimulus is necessary. He stressed that developing countries will find it difficult to indulge in such stimulus due to lack of financial resources. There is thus an urgent need to transfer surpluses to developing countries. The IMF may not be a source of funds for fiscal expansion in developing countries because of its condition that borrowing governments follow stringent fiscal policies. To ensure that developing countries can indulge in such expansion, there is a need to develop a new credit facility. He also argued that regional efforts to provide liquidity, such as the Chiang Mai initiative, must be given consideration. Kregel also drew attention to bilateral and multilateral trade agreements which curtail the policy space for developing countries. Finally, he stressed that global response will require the participation of the entire international community and not just that of a few large nations.

K.S. Jomo (UN DESA) argued that the world is far more integrated today than ever. The crisis that originated in the developed world has hit developing countries really hard. Exports in developed countries have fallen drastically as an outcome of the crisis. Growth of exports in East Asia has turned negative. The growth in foreign reserves of China has now begun to taper off. Developing countries have also been hit through the financial channel as stock prices have plummeted, capital flows have fallen and spreads have increased. The position of many developing countries is stronger today than it was during the East Asian and Latin American crises due to stronger government budgets and higher foreign exchange reserves. However, the reserves of developing countries are fast eroding due to the crisis and fiscal space is also disappearing. The crisis is also going to take its toll on social indicators as unemployment and poverty are likely to increase. Jomo also argued that the response to the current crisis is dismal. The IMF, he argued, was opposed to any serious fiscal expansion by developing countries without surplus. Moreover, $1.1 trillion addition to IMF funds decided in the G-20 is not meant for financing deficits due to additional stimulus by developing countries.

Y.V. Reddy (Ex-Governor, Reserve Bank of India) spoke on the dilemmas before policymakers in the current conjuncture. He argued that fiscal expansion is necessary but any fiscal expansion has to be financed by issuing government debt today. The response of financial markets to such fiscal expansion is thus important and has to be taken into consideration while devising policies. Secondly, he argued that policymakers have to contend with the question of how to divide total financing between debt and guarantees. Thirdly, **Reddy** argued that the impact of fiscal expansion on the external sector has to be taken into account. He also argued that monetary policy loses its autonomy as it tries to support the fisc but this erodes the credibility of monetary policy before financial markets. Discretionary intervention at the time of crisis may create a problem of exit, whereby exit one does not necessarily mean going back to the pre-crisis arrangement but to some optimal desired arrangement. On coordinated policy response, Reddy argued that there can only be directional agreement between countries, not on specifics since each government is answerable to its people.

Arturo O'Connell (Central Bank of Argentine Republic) spoke on the limitations of the current growth and development strategies. He argued that the crisis is going to be long and the policy measures announced so far are small relative to the depth of the crisis. Some of the ideas that have been discredited both in theory and evidence have, however, lived on. One such discredited idea that he spoke about was the beneficial impact of capital flows for developing countries. The idea behind capital account liberalization is that developing countries do not have enough savings, and capital account liberalization will increase savings rate and growth in developing countries. He drew attention to the famous study by Rogoff et al. that showed that "liberalization of capital account is neither sufficient nor necessary for growth". He also discussed an influential study by Rajan et al. (2007) that established a negative impact of capital flows on growth. O'Connell also drew attention to the strategy of export-led industrialization pursued by many developing countries in the recent past. He argued that the current account deficit of the US which has thus far sustained export-led growth in these countries is likely to fall. Developing countries will need to find new sources of growth in such a scenario. In particular, strategy of growth based on government intervention can be tried, but this will require a fundamental change in attitude towards fiscal deficits.

The participants discussed how the blame for the crisis should be apportioned. While the US is blaming surplus countries like China for the crisis, **Massimilliano La Marca** argued that this would be wrong because the countries running surpluses today have grown rapidly on the basis of high investment rates, and did not accumulate these surpluses through domestic deflation. Moreover, had any country other than the US tried to run deficits of such a magnitude, it would have drawn criticism from international financial institutions as well as the US itself. This shows the utter hypocrisy of the international financial system. **Jan Kregel** argued that objective should not be to eliminate imbalances that have grown in the process of industrialization, but to create a system of international reserve currency to which all countries and especially developing countries have access to ensure sustained

growth. Another issue that came up for discussion was whether the crisis will lead to structural transformation of the system or whether recovery within the same structure was possible. Responding to **Reddy's** argument that policymakers may have to consider the response of financial markets to debt-financed fiscal expansion, **Chandrasekhar** argued that if financial interests hinder fiscal expansion then attempts should be made to structurally regulate and constrain finance. **Jomo** and **Kregel** agreed that all attempts till now have been at repairing the system rather than at structural transformation. **O'Connell** talked about the failure of IMF's early warning exercises.

April 10: Session 1- Is Global Keynesianism Possible?

Harry Shutt (independent economist, UK) felt that the answer to the current crisis does not lie in going back to the Keynesian model of yesteryear. He argued that Keynesian policies make the economy liable to inflationary pressure. While these policies worked after the Second World War due to pent-up demand and the massive reconstruction effort, he expressed doubt about whether such policies will work in the current scenario. He pointed out that the present crisis has followed 35 years of declining growth in the world economy. As productive outlets for investment could not be found, speculative outlets were sought through financial liberalisation. He argued that prospects of recovery through traditional fiscal and monetary policies seem bleak. Since households need to rebuild their balance sheets due to past debts, asking banks to lend more in this situation is irrational. Similarly expansionary fiscal policies will soon hit the inflationary constraint. He concluded by arguing that the need of the hour is a radically different economic system that gives priority to meet the needs of consumers, workers and taxpayers. The objective of economic policy should be redistribution not growth. The government should provide flat income support rather than targeting full employment.

Masimilliano La Marca (UNCTAD) noted that the recent crisis has shattered the myth of decoupling, as all developing countries have been hit hard by the crisis. He argued that the crisis was caused by a lack of global monetary system and weak regulatory regime. He felt that countries should respond to crisis through expansionary policies, that these expansionary policies should be co-ordinated and developing countries should be provided sufficient resources to indulge in such expansion. He emphasized the need to focus on the right definition of financial sector efficiency. From the point of view of the regulator, the only relevant definition of efficiency should be social efficiency. The current financial regime generates large private returns but has low social efficiency. He argued that market-based regulation does not work and the need is to complement micro-prudential norms with macro-prudential regulation. Further, to prevent regulatory arbitrage, each institution should be regulated on the basis of its activities. Moreover, since regulatory arbitrage often extends beyond national jurisdictions, there is a need for some international co-operation in regulation. A greater need for multilateralism in macroeconomic

policies was also stressed. In this regard, he argued the need for surveillance of national policies.

The discussant for the session, **Martin Khor** (South Centre) pointed out that Keynes' main problem was the lack of utilisation of existing capacity due to insufficient demand whereas the problem highlighted by Harry Shutt is that of excessive capacity in relation to needs. He argued that the objectives of growth and distribution are compatible. A more equitable distribution of income will have a positive impact on aggregate demand in the economy. Khor also drew attention to the constraints on global Keynesianism in the current conjuncture. He pointed out that many developing countries simply do not have the funds to undertake expansion. Moreover, funds from IMF and WB are available on conditions that require developing countries to follow restrictive policies, and many "free trade agreements" also lock in pro-cyclical aspects of economic policies.

Pasuk Phongpaichit noted that the public at large is sometimes opposed to fiscal expansion because government debt is perceived as a burden on future generations. **Hendri Saparini** argued that we should be concerned about the quality of government expenditure. She also raised the issue of trade liberalisation that is forcing developing countries to rely on imports of even basic commodities. **Erinc Yeldan** was of the view that flat income support should not replace the objective of full employment since unemployment leads to exclusion from community life and has deep social implications. Arguments in favour of surveillance of national policies were also criticised by some participants. **Arturo O'Connell** argued that if deleveraging is not taken care of, the amount of fiscal stimulus required to overcome the current crisis will have to be multiplied. Many participants in this session focussed on the roots of the crisis, and argued that it would be wrong to argue that the crisis has been caused by absence of regulation; rather, it is a reflection of deeper contradictions faced by capitalism. In his response, **Harry Shutt** agreed that a more equitable distribution of income is good for growth, and that the current response to the crisis has ignored this aspect. He argued that his proposal of flat income support, by raising the income of the poor, will have beneficial impact on aggregate demand. **Masimilliano La Marca** agreed that trade integration may have proceeded in the wrong direction but that is not to say that protectionism is right. Responding to the criticism that the crisis has not been caused by absence of regulation but is an outcome of deeper conflicts in the system, he argued that he referred to regulation in the broad sense. Absence of regulation refers to the nature of the financial system itself and the accompanying risks it has created.

April 10: Session 2- Dealing with the Crisis

Mario Tonveronachi (University of Sienna) argued that the current approach to regulation (based on the Basel Accords) is based on *laissez faire* principles, and allows banks to take all types and quantities of risks as far as these risks are properly hedged. The cushion for risks is provided through capitalization, but this

does not provide a cushion against extreme events and systemic instability produced by such events. He therefore proposed that the Basel approach should be abandoned and the objective of regulation should shift from risk calculation and capitalization to risk control. He also argued that assets can be graded according to liquidity. In recent years, the growth of the financial system has been concentrated in assets with low liquidity. In Minskyian terms, the dominance of speculative finance in the financial structure has increased. Such a structure is sustainable only in a low interest rate regime. Therefore in recent years the US Fed has been forced to reduce the interest rate shortly after each time it increased it, but in the process it also validated fragile financial structures.

Ping Chen (Peking University) argued that the exogenous theory of business cycles believes that the market economy is fundamentally self-stabilizing. Drawing on his work in the area of economic chaos, he argued that business cycles are driven by endogenous forces and the market economy is inherently unstable. He presented some evidence of colour chaos in stock price data. He also argued that Lucas' theory of rational expectations was wrong, because Lucas ignored the principle of large numbers, according to which business cycles should originate from the financial and industrial sectors and not from the household sector. **Chen** argued that while the fluctuations of a large number of households would neutralize each other, public companies and giant organizations may generate large fluctuations in investment. Therefore he suggested that giant financial firms that may have contributed to the recent crisis should be broken up into smaller entities. He argued for an international anti-trust law not only for mergers and acquisitions but also for trading in financial market.

The discussant for the session, **Nobuharu Yokokawa** (Musashi University, Japan) argued that a distinction should be made between a cyclical crisis and a structural crisis. A cyclical crisis is a physiological phenomenon that enforces the self-regulating character of the capitalist economy, whereas a structural crisis is a crisis of the capital accumulation regime. He argued that the period of the 1950s and 1960s, known as the Golden Age of Capitalism, was based on a Fordist capital accumulation regime. In this regime wages increased in proportion to productivity, and there was no problem of underconsumption. However, even when the prosperity ended, wages did not decline and the conflict between capital and labour increased, ultimately destroying the capital accumulation regime of the golden age. He argued that in the new regime that evolved after the Fordist regime, booms and busts became a monetary phenomenon and the ratchet effect appeared in interest rates. Once they were reduced in depression, they could not be raised again to avoid premature depression. He suggested that China should try to overcome the crisis by introducing a Fordist regime based on sustained wage increases in proportion to profits. Finally, he argued that since banks function as intermediaries, they can function without capital requirements.

The discussion in this session focussed on Ping Chen's argument that a larger number of agents in the system encourages greater stability. **Prabhat Patnaik**

pointed out that socialist countries under central planning had just one agent but could keep business cycle fluctuations under check. It was argued by **Arturo O'Connell** that the problem in financial markets is not one of concentration but that of homogeneity of decision making. Economic actors apply the same models, which generates herd-like behaviour and instability. **Jayati Ghosh** criticised the proposal for a common international regulatory system with uniform rules for countries at different stages of development. **Leonardo Bulamaqui** asked how one can build an international regulatory structure over national rules, and how an international anti-trust committee as proposed by Ping Chen would function. In his response, **Ping Chen** argued that in socialist countries like China, there is a dominance of large public sector banks that is not good for the system. He further reiterated that the treatment of economic system as exogenous is wrong, since the system is shaped by history that acts as a constraint on behaviour. He agreed with **Arturo O'Connell** regarding the use by agents of similar models becoming a source of instability, and argued that there is a need to develop theories in this direction. In his response, **Mario Tonveronachi** argued that long-term finance will not be provided by private parties, and we should have a public management of long-term finance. He noted that the current structure of financial regulation is not meant for developing countries, and ideally the structure of regulation should take national characteristics into account.

April 10: Session 3- Policy Response in Developed Countries

The third session of the day was chaired by **Leonardo Burlamaqui** (Program Officer, The Ford Foundation, USA). **Todd Tucker** (Research Director, Public Citizen's Global Trade Watch, Washington DC, USA) explored in detail a somewhat incongruous angle of the financial crisis, namely that of the constraints set up by so-called "trade policy." Enumerating the genesis of financial liberalisation with the end of the 'golden age of capitalism', he pointed to the success of the financial services industry in steadily breaking down US domestic financial regulations as well as their success in breaking down trade-related policy space. Under the present GATS norms, it is difficult to make any regulation in any covered area, as it would, in principle, mean a violation of the financial services agreement (FSA). Seen in the context of the US response to the crisis, this then essentially amounts to the impossibility of reinstatement of the Glass-Steagall legislation, banning of or limitation of exposure to derivatives (except those of onions futures!), providing subsidies on a non-national treatment basis—by design or in practice. Accordingly, there have been many different strands of reform proposals, of which the congressional Republican response of 'non-response', is the only one that would probably be WTO-legal. Internationally too, as the latest G-20 statement shows, little attention has been devoted to formulating an international strategy. The London summit communiqué does not address FSA reform, and instead it commits further support for the WTO Doha Round, which includes the built-in agenda of further financial services deregulation. In all, even though the existing models of finance have failed, the US as well as other developed country governments do not appear to be pushing for

fundamental reforms. Many of the proposals they are pushing domestically, however, are violations of the spirit if not the letter of the FSA. In this context, it is essential for developing countries to distance themselves from the successful completion of the Doha Round of WTO talks.

Enrico Wolleb (Director, ISMERI Europa Foundation, Rome, Italy) the discussant of the session, enumerated the response of the European Union to the financial crisis. Citing **Carlo Panico's** paper, he described the formation of the euro area as well as the evolution of the management of the crisis during the different phases as a testimony to the professional ability of the monetary authorities of the euro area. They have been able, with the support of the fiscal authorities in the second phase, to keep tensions under control. In that sense and for many other reasons, the Euro-system is considered to be a success story. In fact, without the Euro, many European members would have resorted to competitive devaluation in the face of the current crisis. However, as the documents of the ECB point out, the EU is now probably entering a third phase where the negative effects of the crisis on the level of activity may spark a more traditional credit-cycle downturn. During this phase a major role has to be played by fiscal policy, which must prove effective in supporting the different sectors of the economy. However, other than the lack of satisfactory arrangements for policy coordination, there was also the problem of the fiscal package to be adopted. Governance of fiscal policy has the limitation of capping the fiscal deficit at 3 per cent of GDP and the public debt-GDP ratio at 60 per cent of GDP. The European recovery plan is also inefficient in size for it means that European countries can spend only 200 billion euros from their national budget (which is a mere 1.5 per cent of their GDP) and that too for only one year. This is inadequate in the context of 2.7 million job losses, as a result of which many of the new members of the EU are under severe strain.

The discussion during this session saw healthy and spirited comments and queries centering on issues related to the future of the Euro area, with special focus on implications for new members of EU and the effectiveness of both the USA's and EU's fiscal stimulus. **Zhao Changhui, Terry McKinley and Harry Shutt** all raised the point about the future of Euro in the face of the crises worsening further, especially on the issue of the new members being forced to beak away. **Yilmaz Akyuz** also queried whether the lack of a unified system (like the US Fed) in EU could lead to the break-up of the EU. **Prabhat Patnaik** wanted to know whether the differences in approach of Britain and Germany to a fiscal stimulus result from their different political outlook or because of the differences in the influence of finance capital. **Y V Reddy** pointed out that there is a need to understand USA's interest in financial liberalization all over the world.

In response to Todd Tucker's presentation regarding US fiscal stimulus, **Jayati Ghosh** raised the point about the author's assessment of the effectiveness and role of the US fiscal stimulus package. **Jan Kregel** quizzed whether it is at all possible for any other country to drag US to a dispute settlement court, as mentioned by Todd Tucker in his presentation. **Y V Reddy** made the point that the main problem of lack

of coordination in the EU arises because of a system of single monetary policies along with multiple fiscal policies. And the problem of coordination at the world level can be seen as that arising from multiple fiscal policies coupled with multiple monetary policies.

Answering the queries, **Enrico Wolleb** clarified that the EU is not dead; it has many positive aspects like the European Central Bank and it also has a strong role in trade. About the differences in approach to fiscal stimulus, he said that the main reason for Germany not favouring a fiscal stimulus is because they do not want even minimum leakage via external trade. In an answer to Yilmaz Akyuz's query, he agreed that though there are some common regulatory bodies, it is not enough because of the limited role of the ECB. But all is not lost since the Union is still under construction. **Todd Tucker** agreed that under GATS it is very difficult to know if a case will be brought, and that a major worry is that a case could be brought under the investor-state provisions of a bilateral FTA or BIT, such as the U.S.-Panama. Also, it is difficult to comment on the impact of the US fiscal package, as there is already enough resistance against it.

April 10: Session 4- Public Panel on China

The last session of the day, chaired by **Zhao Lei** (School of Economics, Southwestern University of Finance, Chendu, China) was devoted to understanding the role of China in the current financial crisis, the genesis and the nature of the crisis in China as well as its implications for China. Speaking about the role China is alleged to have played in the current financial crisis, the first speaker of the panel, **Cui Zhiyuan**, School of Public Policy and Management, Tsinghua University, Beijing, China, pointed out that since December 2008, there has been a general build-up of public opinion (first proposed by Bernanke) that China's savings, following the global savings glut theory, is responsible for the current financial crisis in the US. The paradox of the rigidity of the long-term rate of interest, despite Bernanke raising the short-term interest rate, was apparently because of the expectations of flow of savings from China. He argued that there is some element of truth in the allegations as savings surplus from emerging economies does make macroeconomic management more difficult. However, given the current state of international uncertainty, it is well known that China has little option but to recycle its dollars to US Treasury Bills. In this regard, the G-20 has argued for an enlarged SDR not only for China but also for the US as a major asset or holding surplus savings. In effect, the argument of a global savings glut is not actually blaming China, as has been misconstrued by many. Speaking on the impact of the financial crisis on China, **Cui Zhiyuan** emphasised that the growth of the Chinese economy is actually not as dependent on foreign trade as it is generally made out to be. While it is true that China's external trade-GDP ratio is close to 70 per cent, a major part of it is owing to a large import-GDP ratio and the significance of processing exports. However, there is no doubt that the current financial crisis and the ensuing recession in large parts

of the world would put additional pressure on China to rely more on domestic demand. And that is where China needs to put the maximum focus.

Zhao Changhui (Chief Country Risk Analyst, Export-Import Bank of China and Director, Asia-Africa Development and Exchange Society (AADES), Beijing, China) noted that because of the global downturn, the Chinese economy has lost at least 30 per cent of its export volume. There is, therefore, a need for finding new avenues of cooperation and new tools for economic revival. One such tool is to provide credit to the manufacturing sector as well as to the financial sector. In fact, China can also contribute towards saving collapsing industries in many parts of the world. In this regard, the Chinese government had already made one positive move. Till last month, the EXIM bank could only give loans for export and import and the fund had to be raised internationally. But now the Chinese government has allowed the bank to use money from government reserves. In all, the EXIM Bank of China has been trying to find new leverage for dealing with the crisis in general and the outside world in particular.

Xu Jiankang (Director of the Economics Department, Journal of China Social Science, Beijing, China) examined in detail the nature of the crisis in China and its impact on the Chinese economy. Speaking about the crisis in general, he said that, following Marx, it is widely known that self-regulation is institutionalised in capitalism. However, after every two to three decades, the self-regulatory aspect of a capitalist system stops working, leading to a full-blown crisis. Regarding the current crisis, he said that neoliberalism has had a deleterious impact on China's economic policy. In the current regime, there is a wide division between the virtual and the real economy, with the former growing at a much higher pace. Though the crisis is endogenously generated, the need is to find exogenous forces to deal with the crisis. In the case of China, there are at least two challenges that it needs to deal with. One, the export-led strategy of growth cannot be sustained any longer. Two, the already huge and still growing inequality between urban and rural populations needs to be addressed, without which it will be difficult to boost domestic demand. A regime which is open but doesn't consider the national interest, cannot survive in a volatile world. Thus, there is a need to find balance in this turmoil, especially since China is facing more pressure for further liberalisation. The impact of neoliberal policies is apparent in the case of China's banking system, which has more or less gone bankrupt. The impact of that is only beginning to be felt in the real economy. But till now, China hasn't been able to deal with its structural imbalances, which would have to be the first task for dealing with the crisis.

Zhang Yu, (School of Economics, Renmin University, Beijing, China) spoke about the Chinese model of growth, and why China is in a better position to deal with the impact of the global financial crisis. In his view, the Chinese model has sustained high growth since its transition to a system by combining the socialist system with a market economy system. In the arena of opening up, China has resorted to a gradual and controlled policy of opening up while sticking to fundamental national policies. As a result of following this particular growth strategy, better known as

'socialism with Chinese characteristics', the period since transition has witnessed greater urbanisation and industrialisation than ever before. However, the current crisis has seen slowdown in China's economic growth since December 2008. Imports and exports have fallen drastically, registering, for the first time in many years, negative growth in both the trade figures. No doubt this crisis poses major challenges for China, but it is also an opportunity as China has certain advantages. These arise from the fact that the government has strong controls on capital flows, which is the key to the success of China's growth model. Second, unlike in the past 30 years, because of China's increased integration with the rest of the world, it would be able to play a stronger role in decision making regarding the approach adopted for dealing with the crisis. While the yawning wealth gap needs to be addressed urgently, all the factors necessary for long-term growth remain, which gives an advantage to China vis-à-vis other economies, in dealing with the crisis.

The last speaker of the panel, **Andong Zhu** (School of Humanities and Social Sciences, Tsinghua University, Beijing, China) spoke in detail about the evolution of the Chinese economic model from being primarily a semi-feudal, semi-colonial backward economy in the pre-1949 era to an independent, economically and socially balanced model beginning in 1949, and finally its transition to a market-oriented system of growth since 1978. In this process, among the noteworthy achievements in the post 1949 period were those of building up a broad-based industrial structure, generating a high growth rate of around 6.68 per cent per year during 1953-1978, along with all around improvement in human development indicators. The period since 1978 too has seen fast GDP growth. In addition, there has also been a marked increase in China's foreign exchange reserves. However, this is also the period when income inequality had worsened and so has the social development environment. In the period from 1978 to 1992, China followed a model of planned economy with market mechanism. In the second period beginning from 1992, the emphasis was on marketisation, privatisation and liberalisation. Since 2001, the year of China's accession to WTO, things have taken a turn for the worse. Widening income inequality and the ensuing decline in domestic consumption-GDP ratio have led to over-dependence on investment and the international market. And the main reason for rising inequality is excessive privatisation of the economy. It is ownership issues which lie at the bottom of worsening income distribution and labour relations. Seen in terms of the share of Chinese industrial output by ownership, over time, there has been a shift away from state-owned and collectively-owned enterprises to domestic and foreign private enterprises. This in turn, has led to growing unemployment and increasing informalisation of labour. Therefore, the time has come for China to think of a strategy of growth that can lead to a balanced and sustainable economic development, which is less dependent upon the international market and on investment. The thrust should be on increasing private consumption by increasing incomes of the poor, improving the social security net, coupled with (re-) nationalization of enterprises and more strict regulation of the market. The time is opportune for making these changes, given that China has enough room for using fiscal and monetary policies owing to low external debt risk and public debt.

The session induced intense discussion from the participants. **C.P. Chandrasekhar** observed that until now a large part of China's trade, particularly with Africa, has been extractive in nature, somewhat like what imperialist forces had engaged in earlier. He queried whether one could now expect a change in China's stance in these areas. **Todd Tucker** specifically wanted to know the impact of China opening up its banking and insurance to foreign participation. **Prabhat Patnaik,** expressed his surprise as to why China has not, till now, resorted to using fiscal stimulus for raising social wages, if not raising wages directly, especially given the state of inequality mentioned during the panel discussion. **Pasuk Phongpaichit** had a query regarding the time-frame of China being able to come out of the crisis. **Yilmaz Akyuz** said that it is incorrect to think that to solve the problem, China has just to drop dollars and shift to SDRs, simply because SDRs do not work if they are being used for holding assets and not for spending them. Many of the participants made interventions about the sectors which need re-nationalisation, as well as on economic conditions in China and gave insights on the recent developments in the country.

April 11: Session 1- The Nature of the Crisis

The first session on 11 April 2009 was chaired by **Rashed A. Titumir** (Regional Policy Coordinator, Action Aid International, Asia, Bangladesh). **Zhao Lei (**Professor, School of Economics, Southwestern University of Finance, Chendu, China) argued that the basic dilemma facing all market economies in the current times is the dilemma of overdraft (for consumption) or overproduction. The sub-prime mortgage crisis too had its own logic, which is nothing but the inherent contradiction of a market economy, i.e., that of insufficiency of effective demand, leading to overproduction and then to overdraft consumption, followed by rising default rates and finally, the sub-prime mortgage crisis. Apparently, there is some difference in the nature of the classical crisis and the modern crisis. In case of the classical crisis, like the Great Depression of 1929, inadequacy of effective demand was thought to be the direct cause, while, in the case of the modern crisis—the sub-prime mortgage crisis for example—the reason appears to be the "excess" of effective demand, or "overdraft consumption". However, both kinds of crises are essentially because of overproduction. That is, in the present crisis, "overdraft consumption" is not the root cause. The inherent contradictions of the market economy or in other words, insufficiency of effective demand is at the root of the crisis. In case of the present crisis, capitalism, had no way out but to resort to overdraft consumption, in order to release the insufficiency of effective demand. In other words, overproduction brings overdraft consumption, which in turn leads to financial crisis. Because China is still in the early stages of being a market economy, it is yet to face a crisis of the modern variety. However, following the market economy model would soon see China also facing the calamities of modern crisis.

Erinc A. Yeldan (Bilkent University, Ankara, Turkey) in his presentation analysed in depth the nature and causes of the current collapse of the wealth of nations, bringing forth, on the basis of key statistics on the global history of capitalism, the argument

that it is the very structure of the global financial system that lies at the base of the current crisis. Unlike the crisis in the 1970s, the current global crisis is not rooted in the falling rates of profit and/or increasing organic composition of capital; rather, it is the result of the financialisation, resorted to in order to deal with falling rate of profit at the end of the "golden age".

The discussant for the session, **Praveen Jha** (Jawaharlal Nehru University, New Delhi, India) noted that both the papers point to the fact that the root cause of the crisis is underconsumption. Financialisation was used as a tool to come out of the crisis. This has had its own implications for trade, production structures and growing inequality. Two main points were that there has been increasing erosion of the strength of labour and a growing conflict between productive and finance capital.
In the discussion that followed **Jayati Ghosh** queried as to why capitalism as a system had managed the wage problems (through debt if not direct rise in wages) in some years but has chosen to ignore the problems in other years. **Terry McKinley** asked whether the cycles of overproduction and underconsumption can carry on indefinitely, and wanted to know the factors that can exacerbate the crisis, i.e., lead to dampening or explosions of the cycles. He also wanted to know about the implications of decline in wages as mentioned by **Erinc Yeldan** in his paper. **Pasuk Phongpaichit's** query was regarding the coalition of forces in China that can bring about the elimination of private property. **Sandeep Chachra** asked about the possible reaction of the current social forces to the idea of a flat-income support for the common people.

April 11: Session 2- Responses in Developing Countries I

This session was chaired by **Dashu Wang** (Beida Economics Department, Beijing, China). **Martin Khor** (Executive Director, South Centre, Geneva, Switzerland and Third World Network, Malaysia) argued that the impact of the crisis on the developing countries is likely to be far worse than that on the developed countries, because of these economies' lack of the means to counter the effects. There are two transmission routes through which the crisis is affecting the developing countries, namely, trade and finance. In case of trade, there has been significant drop in exports of manufactures in the post-crisis period. In finance, there has been fall in bank loans to developing countries, reversal of portfolio investment and slowing down of FDI to these countries. As a result of these and the concomitant squeeze on trade financing, the overall balance of payments and foreign reserves in many developing countries are coming under stress. Consequently, many developing countries might face the renewed problem of servicing their external debt and avoiding a debt default situation. Going to IMF for loans is not a healthy option, given that there has been little change in IMF's policy stance. However, the option of spurring the domestic economy is limited, especially for small countries. While the policy response of each country has to be tailored in accordance with the differential impact of the crisis, at an overall level, there might be compulsions for greater regionalism, initiatives at bilateral and trilateral levels, without necessarily falling

back on strategies like the Chiang Mai initiative or going to the IMF. Referring specifically to the case of Malaysia, he reaffirmed the need to re-impose a moratorium on capital outflows from the country.

Hendri Saparini (Managing Director, Econit Advisory Group, Jakarta, Indonesia) expounded in detail the differences in the origin, nature and impact of the East Asian crisis in 1997 and the current crisis, pointing out that the policy blunders of the previous crisis are being repeated in dealing with the current one. The policy response in the 1997/98 crisis, under the aegis of the IMF, had been to follow a tight money policy, liquidate banks, take over private sectors debt, reduce subsidy, raise tax, followed by accelerated liberalisation of the real sectors. The nature of the current crisis is different from the previous one owing to emergence of increasing contradictions between improving financial indicators and slowing growth of the real sector, combined with accelerating de-industrialization. In Indonesia, the main reason for the formation of the financial bubble has been the inflow of hot money, which has strengthened the Indonesian currency, Rupiah, against other currencies and bid up the prices of domestic assets. The observed rise in exports too had been mainly on account of rising international commodity prices. Meanwhile, the growth of the banking sector has been largely illusionary, driven mainly by the large net interest margin and not supported by strong fundamentals, e.g. credit growth. Since 2007 the financial bubble has only grown in size and volume, extending even to property and consumer credit sectors.

On the side of the real economy, there has been acceleration of de-industrialisation with the gap between real GDP and manufacture production widening over the past eight years of following IMF-advised policies. In 2007, gross investment registered growth of only 8 per cent from the low levels of the year before. Further, in the wake of the present crisis, Indonesia's exports of non-oil commodities, which constitute 63 per cent of total Indonesian exports, have dropped sharply. While international prices have reduced drastically, the same has not been true for domestic prices. However, there has been little change in the policy response to deal with the crisis, with the focus on imposing a tight money policy and reducing interest rate. Even the fiscal stimulus, counter-cyclical in nature, is not likely to be effective, as 80 per cent has been allocated for tax concessions, not for direct spending. This would lead to increase in budget deficit and public debt. She concluded by suggesting that the government should instead re-orient policy in the financial sector, strictly managing the hot money and making capital control/capital regulation a priority to make finance support the real sector. Further, it should develop and restructure the manufacturing sector and increase productivity to strengthen the fundamentals of the economy. While minimising the amount of debt, the fiscal stimulus should emphasise direct public spending.

The discussant **R Ram Kumar** (Tata Institute of Social Sciences, Mumbai, India) said that both the papers brought to the fore the debilitating impact of the financial crisis on economies of the developing world and on the common people. He further pointed out that the human cost of the current crisis goes much beyond the witnessed

increase in unemployment. Financial liberalisation is the root cause of this enormous human cost through three broad routes: greater fragility and hence being constantly hit by crisis after crisis; the changed idea of development finance; and the attack on millions of people's livelihood (e.g. farmers) because of the decline in directed credit. Recovery and rehabilitation requires reverting away from such neoliberal policies. Through the years of economic liberalisation, there has been constant rundown of social security and the present crisis provides the opportune moment for increasing social security.

Pasuk Phongpaichit said that developing countries stand a better chance in dealing with the crisis because of their relatively stronger position in public debt and accumulation of reserves, and therefore they should push for greater public investment in infrastructure and social sectors. **Prabhat Patnaik** pointed out that when there is a strong tendency towards liquidity preference at a global level, it translates into preference for US dollars and if the crisis continues, this would become even stronger, necessitating strong regulations and controls on capital outflows. **Arturo O'Connell** too pointed at the need for imposing controls on capital outflow. **C.P. Chandrasekhar** commented that from **Martin Khor's** argument regarding the transmission routes, it seems that the problem in the developing countries is mainly because of problems in the developed countries. However, if financial liberalisation could very well result in a similar kind of sub-prime crisis, even in the developing countries, there is a need to re-structure the financial sector in these countries.

April 11: Session 3- Responses in Developing Countries II

Terry McKinley (School of Oriental and African Studies, London, U.K) chaired this session. **Juan Carlos Moreno Brid** (Research Coordinator, CEPAL and UN-ECLAC, Mexico) discussed the characteristics of development of the Mexican economy and its main strengths and limitations, following years of macroeconomic reforms based on neoliberal policies. He argued that the cut in public investment was not compensated by a rise in private investment, leading to lack of dynamism in investment. Trade and FDI have been mainly concentrated with the US. Reduced state intervention has also had the effect of lower tax revenues, with the public fisc very dependent on oil, which accounts for one-third of revenues. The domestic banking sector is owned by foreigners and financial intermediation has remained weak. Large income inequality, significant poverty and insufficient employment generation have meant slower economic growth with a similar level of trade deficit as was experienced in the earlier (import-substituting) phase of higher growth. Identifying the main channels of transmission of the crisis on the Mexican economy, his contention was that it would be felt mainly through the balance of payments and demand for exports route. In terms of the responses, he felt that the government has not focused on the regulatory aspects of the financial sector at all. Instead, the whole focus has been on fiscal and monetary actions to stimulate domestic activity, stabilise the foreign exchange markets and avoid a spurt of inflation. Short-term response must try to

alleviate the impacts of the crisis as well as remove constraints on Mexico's economic long-term growth, which implies a greater role for the State: improving its regulatory capacity; increasing its role in allocation of resources; undertaking fiscal reform and increased investment in infrastructure; promoting industrial policies; avoiding persistent depreciations of the real exchange rate; strengthening domestic financial intermediation; and moving towards universalism in social protection policies.

Noemi Levy (Universidad National de Mexico, Mexico City) in her presentation also focused on the contours of the development of Mexico in the era since the adoption of neoliberal policies and its impact on Mexico in particular and the developing countries in general. According to her, developing countries face a different type of crisis. In case of Latin America industrial recessions could very well induce a financial crisis. After the Tequila crises, Latin American economies turned into export-led economies, with reduced home markets, Mexico being the most outstanding case in the region. These countries, specifically Mexico, have been experiencing low rates of economic growth, de-industrialization (because of the institutional changes in the 1980s and 1990s) and low levels of finance provided to domestic non-financial agents. In this regard, a significant point to be noted is the increase in liquidity with reduced levels of finance. Analysing the reasons and effects of high liquidity and low credit, she pointed out that in Mexico at least, the current economic crisis differs from the contemporary crises of industrial economies, in the sense that economic stagnation did not emerge because of financial innovation, higher credits, followed by default payments and a generalized bankruptcy of the financial system. Instead, the present crisis is due to a generalized fall of external demand (exports) with no domestic mechanism to revert this situation. Regarding the policy response to the crisis, she brought attention to the fact that so far the current Mexican rescue programmes have proved to be highly ineffective, as they continue to concentrate on stabilizing the exchange rate and further opening the economy, in order to resume economic growth.

Saul Keifman (University of Buenos Aires, Argentina) noted that the main message of both papers is about unfulfilled promises of neoliberal policies. The supposed benefits of following these policies for Mexico was based on the Hecksher-Ohlin hypothesis, which fails in the face of factor reversal. Also, Mexico's increased trade with USA has been concentrated in exporting inputs and has therefore not led to much value-addition and/or increase in employment. The basic messages as brought out in both the papers is that financial liberalization has little to do with growth and investment and the rate of investment is not necessarily constrained by savings, as these policies often tend to portray.

Yilmaz Akyuz queried the reasons behind exceptionality in the period of the boom witnessed in Latin American countries from 2002 to 2008, when the continent saw easy availability of money, cheap credit and surge in foreign trade. **Massimilliano La Marca**, wanted to know about the various obstacles that Latin American countries in general and Mexico, in particular, face in terms of following growth-oriented, equitable industrial policies. In her response, **Noemi Levy** argued that the crucial

constraint on the industrialization of Mexico was liberalization of FDI in 1994. She pointed out that foreign capital in Mexico relies heavily on imported inputs and does not generate domestic employment. She also pointed out that the period 2002 to 2008 was good only for developed countries. Developing countries were sources of cheap exports on the basis of cheap labour. She pointed out the worsening income distribution in developing countries. **Juan Carlos** argued that besides factor reversal, the Hecksher-Ohlin hypothesis breaks down when a third country is introduced. He also argued that Latin America faces the problem of domestic capital outflow and some degree of capital controls need to be implemented. He argued that 4% growth attained by Latin America in the last few years is commendable compared to recent historical record of growth in this region. Moreover, he argued that extremely skewed income distribution in Latin America has acted as a constraint on growth in this region. Finally, he noted that low tax revenues act as a constraint on policy space in Mexico.

April 11: Session 4- Panel on New Directions in Regulation

In the last session chaired by **Jan A. Kregel**, the discussion veered around suggestions regarding policy responses for dealing with the crisis, with special focus on the developing countries.

Jomo K. Sundaram, UN Assistant Secretary-General for Economic Development, UN-DESA, United Nations, New York, USA, opined that there are three types of challenges facing the South. The first is to limit the spread across borders as well as limit the spread from the financial sector to the real economy, particularly in terms of providing liquidity.

The second set of challenges is related to trying to reflate the economy and for this fiscal space is needed. While in the recent times the IMF too has been espousing the role of fiscal stimuli, it is, however, conditional on and recommended only for countries which have a fiscal surplus to begin with. The third is the broader medium-term challenge of regulatory reform at the national level, which is usually the appropriate domain for such reform. There is also the additional and perhaps more important challenge of international reform, which is important because there is no proper authority which is an inclusive body overlooking such reform.

In this context, one particular challenge in terms of reform priorities would be to ensure that regulation is counter-cyclical rather than pro-cyclical. Another challenge would be to develop and reaffirm the need for capital control in order to stem excessive and undesirable capital inflows as well as sudden, disruptive large outflows. The third major reform would be to ensure that fiscal and monetary systems are used for more than just crisis management or crisis avoidance. Fiscal and monetary policies should be able to provide affordable financing for productive long-term investments, e.g. development banks, commercial banks, deeper financial markets, and especially bond markets. Reforms in the domain of finance should be

more than just prudential risk management, but should also be about financing growth; it should develop counter-cyclical measures and should support developmental and inclusive finance.

Arturro O'Connell emphasised the need to distinguish between monetary and fiscal policies, especially in the case of the developing countries. With regards to the domestic financial system, he contended that the financial sector need to be attuned to developmental needs, which can be attained by, among other things, going back to the old-style commercial banking system, increase in average duration of lending along with increased participation of development banks and the government. Regarding financial regulation, he argued that initially there was some consensus regarding the failure of the market mechanism, but there is now a growing disagreement about what is to be done. While there is consensus on issues of 'tax havens', there is less agreement regarding Basel II. At least in the financial sector, the invisible hand does not work and because of many externalities, state intervention is essential. The main issue is to what extent can there be regulation, as already there has been some backtracking from the initial opinion of nationalisation and treating the sector as public utilities. Going from domestic to international issues, he spoke about the need to defend institutions of exchange rate control, in which of crucial importance is the need to avoid capital inflows, control outflows and, in general, the need for 'regulatory capture'.

Prabhat Patnaik pointed to the fact that capitalism is passing through a defining moment, in the sense of being pregnant with possibilities of transformation. The current crisis is similar in nature to the crisis of the 1930s. Historically, capitalism as a system has always tried to resolve crisis with the help of an external prop. In the pre-war period, it was the extended settlement areas and the markets of the former colonies and later on in the post-war phase, Keynesianism came as the external prop, which was possible because of a changed political situation. The new external prop can be by way of revival of state intervention which has to take on the hegemony of international finance capital. Therefore, a democratic agenda has to constitute a coordinated fiscal policy, with enhancement in areas of welfare funding. The second agenda would have to be some control over capital flows. The third agenda would have to be of asymmetric protectionism—with the North not adopting protectionism, while the South is accorded some space for protectionism, essential for industrialisation. In terms of regulation, in an environment of political hegemony of global finance capital, the issue cannot be reduced to merely that of one regulator. Concerted efforts have to be built up against international finance for a more democratic world order.

Yilmaz Akyuz (formerly UNCTAD, Geneva) argued that reform efforts made till now were insufficient. Asia had been hit by the crisis because of being unable to manage external capital flows properly. After 2002, there has been a surge in capital flows and in many countries inflows were liberalised so as to gain from the capital flows. At the same time they tried to use sterilisation but could not do so effectively, as a result of which monetary policy became expansive leading to bubbles in the stock

and property markets. When the US sub-prime crisis occurred, these bubbles burst. So Asia today is far more integrated with the world financial markets, and therefore there is strong need for capital control as well as domestic policies.

Y. V. Reddy (Ex-Governor, Reserve Bank of India) said that by 2005, central banks of most countries were aware of the excess liquidity in the systems, and also recognized that the risks were under-priced. Financial markets, however, argued that markets knew the prices best and any intervention could lead to risk of policy mistake. Also, over time the link between financial markets and governments became stronger and there was strong regulatory capture, which brought in its fold, even economists and the media. This regulatory capture led to the deregulation of the financial system. Speaking about the new directions in financial regulation, he emphasised the need for counter-cyclical policy with management of external capital. In this regard, governance and ownership issues too require better resolution. The development aspects of financial system need to be focused on, and for that responsibility of regulation should be national responsibility to the exclusion of a global regulatory system.

Yu Yong Ding (Institute of World Economics and Politics, CASS, Beijing, China) began by saying that the world has entered a new turning point. For China, the crucial issue is about the policy choices to deal with the crisis. The current financial crisis has exposed the limitation of China's growth strategy, and it is because of this particular strategy of growth that China is now facing the problem of overcapacity. Till now, external demand had kept this capacity utilized, which in effect means that foreign demand had helped China disguise this problem of over-capacity. In fact, in the steel industry alone, more than 56 per cent of drop in demand can be attributed to the fall in external demand. Those who deny this dependence on the external market do so because they only look at net exports, which, however, do not portray the true picture about the state of Chinese economy. Regarding the huge reserves that China has accumulated over the years, he argued that any further increase in the supply of dollars would lead to devaluation of the dollar. This then leads to problems as China does not want its dollar assets to be devalued, and the proposal of SDRs does not solve this problem. In terms of overall policies, there is a need to re-think and adopt policies which are more humane and can deliver some distributive justice.

In the general discussion, **Jayati Ghosh** pointed out that a lot of the problems China is facing today with regard to dollar accumulation are perhaps because of having mainly concentrated on trade with US, and diversification of trade especially with developing countries could resolve the problem somewhat. **Nobuharu Yokokawa** suggested that China can reach full employment by increasing wages at the same rate as rise in productivity. In the process China can also resolve the problems regarding investment and lack of effective demand, and hence also tackle the problem of current account surplus. **Massimiliano La Marca** enquired whether counter-cyclical capital controls can be effective in helping developing countries deal with the problem. **Cheng Furui** (PhD Candidate, School of Public Policy and

Management, Tsinghua University, Beijing) enquired about China's possibility of solving the trilemma of an independent monetary policy, along with exchange rate stability and capital account convertibility. **Rashed Titumir** wanted some clarifications regarding the regulatory capture mentioned during the panel discussion. **Terry McKinley** expressed his doubts regarding correcting global imbalances and massive unexpected depreciation of the dollar and non-continuation of the dollar as the reserve currency.

Jan A. Kregel summed up the main messages of the conference and the lessons learned for future action, saying that the crisis provides an opportunity for introducing measures to bring back normalcy. In this regard, it is essential to have the right theory and put that into practice. In terms of learning from the crisis, the first lesson is that, although in general a system is not supply constrained, the financial system tries to ensure that it is so, in order to earn substantially higher returns. Then, in order to get out of the crisis, there was general agreement on the need for stimulus policies, and debate about national versus global coordinated policies to take care of cross-border spillovers. This, then, led to the idea of national versus global regulations, with the idea of favouring national regulations in the realm of finance and using various types of protectionist policies (for the South). On the question of the stimulus, direct state intervention in the real economy is necessary to stem and alleviate the inequalities fostered by years of dominance of finance. There is also the need to develop longer-term proposals on SDRs as an alternative policy, even though SDRs alone cannot provide the way out of the crisis. As a consequence of the domination of finance, finance has extended to destabilising other markets such as that for food, and there is the growing inequality of income both within and across countries. In this regard, control on capital flows is one of the crucial components of the changed financial architecture. Finally, there is the possibility and opportunity for UN to lead the reform process and the challenge of reinvigoration of a zombie IMF.

The conference ended with a vote of thanks by **Jayati Ghosh** from IDEAs. The three day conference was successful in bringing out the different aspects of the problem of re-regulation in the backdrop of the global financial crisis. Though individual experiences of and suggestions for various countries differed somewhat, there were many commonalities regarding the policy space, the kind of policies to be adopted as well as the need to move towards policies with greater state intervention at the national level in all sectors, especially that of the financial system, of the economy. The spread and mix of the participants spanning countries of various continents from Latin America, USA, Europe and Asia provided a wide canvas and helped evolve a more comprehensive understanding of the problem.