



# The Global Crisis

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# Chronicle of the Crisis

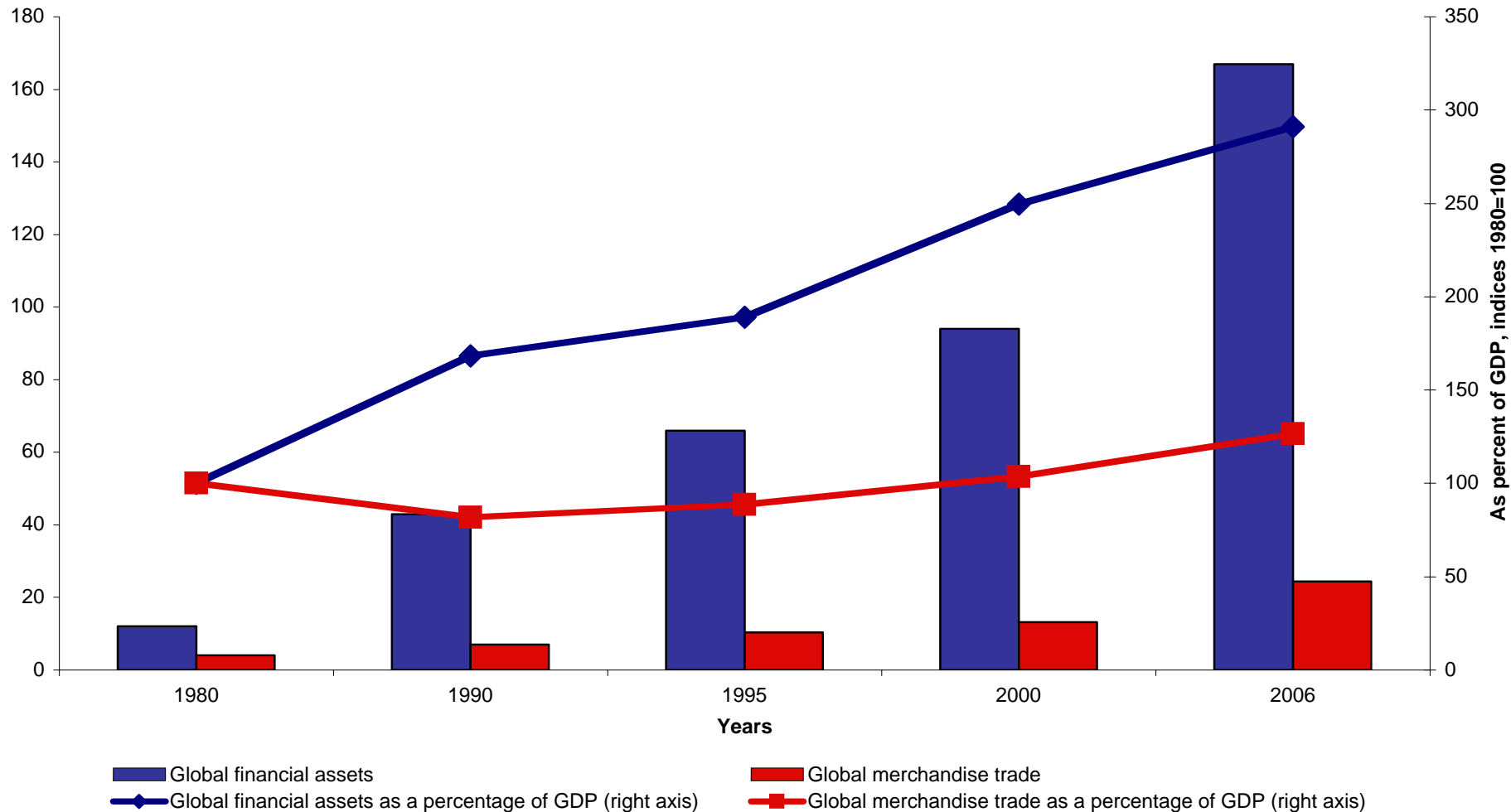


- No One Expected? *Crisis foretold*
- Preceding *global imbalances*: unsustainable
- International financial *architecture*?
- *Ideology*: deregulation, self-regulation, capital account liberalization
- *Financial Globalization*: growth, stability?
- *Policy responses*: double standards
- Rescues not for *innocent victims*
- *International cooperation*: G7, G20, UN

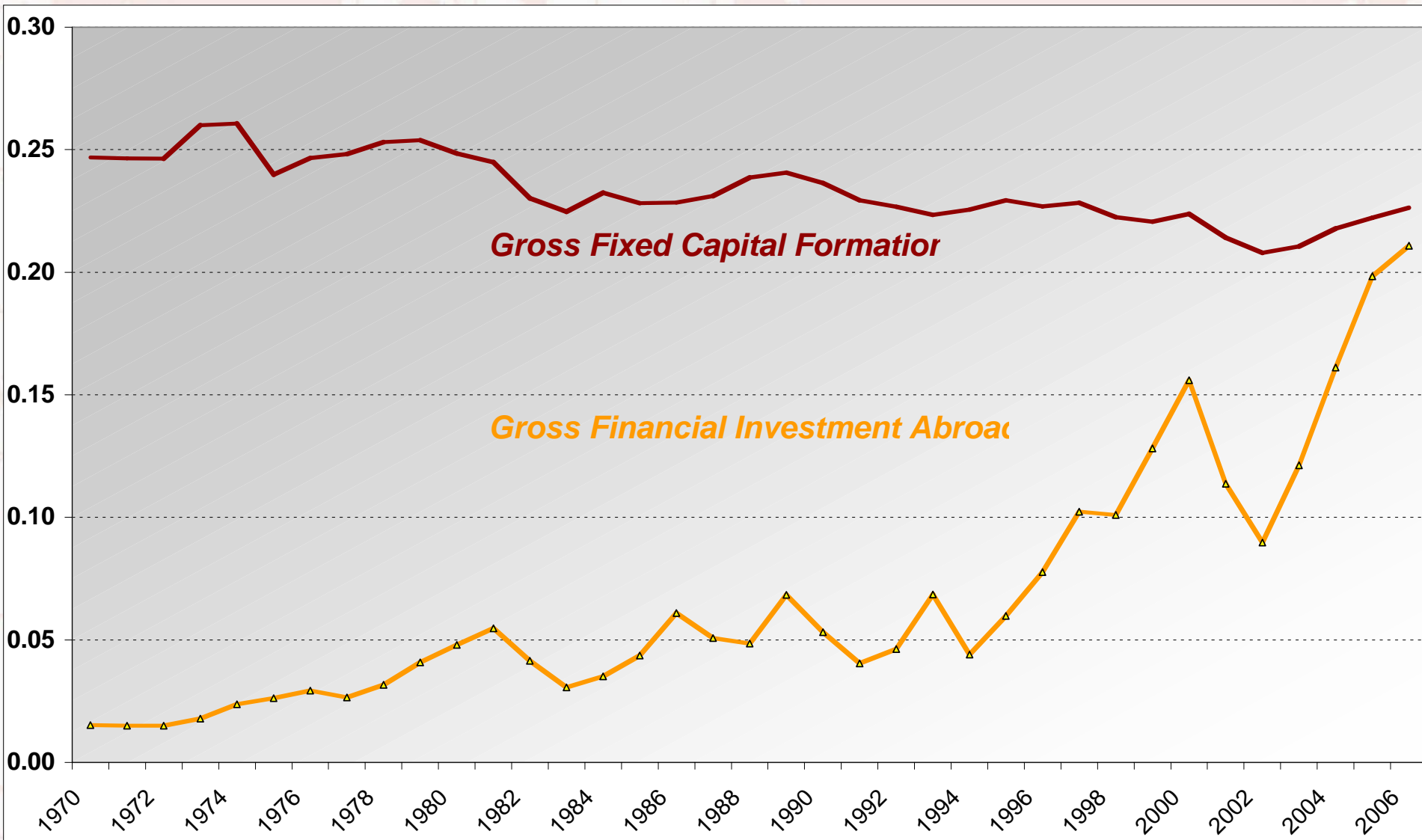
# Globalization: finance > trade



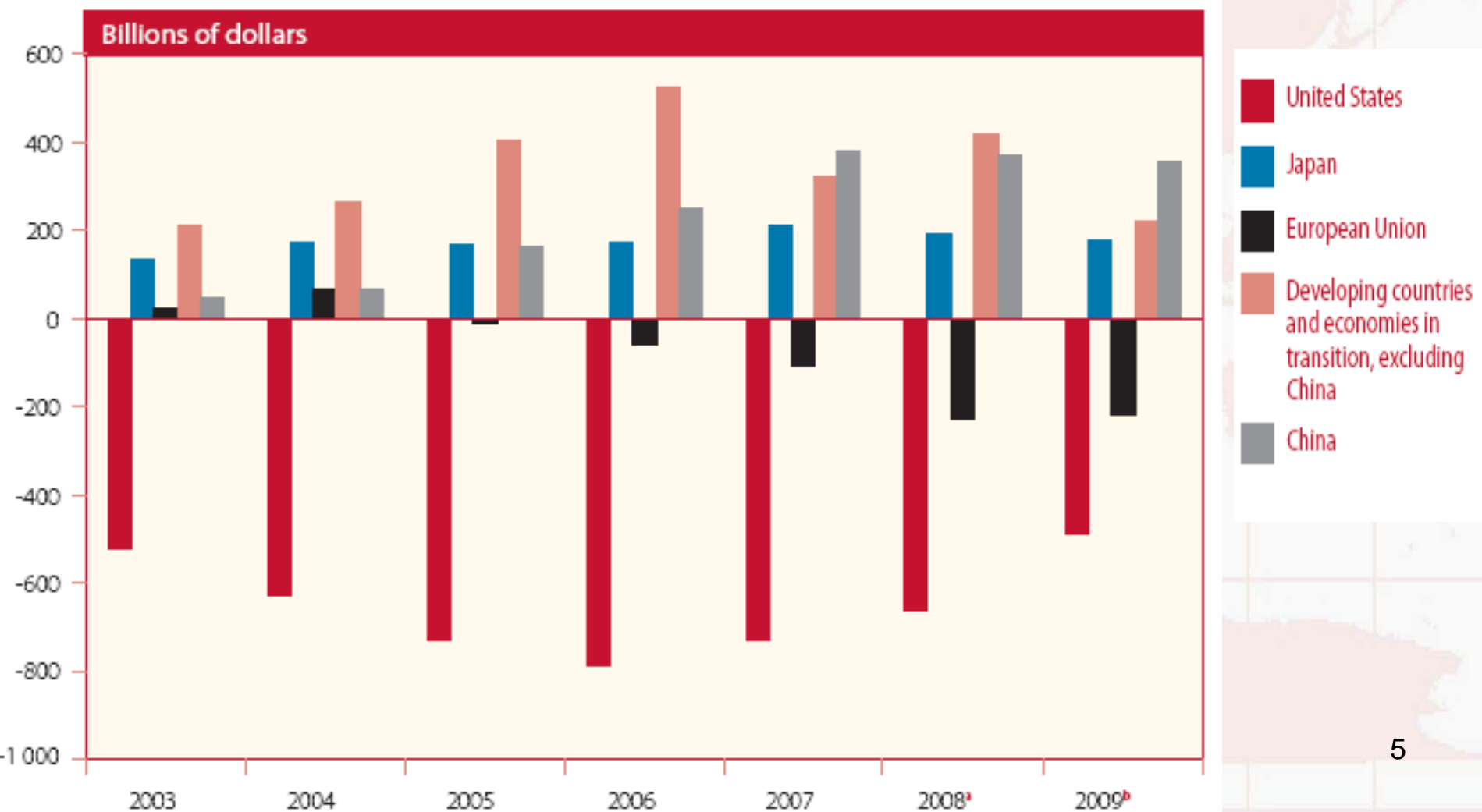
Figure 1  
Finance driven globalization



# Finance-investment nexus?



# Global imbalances remain, but shifting



# Crisis unfolds: 3 vectors



## **Financial vector:**

Sub-prime crisis → financial crisis → asset price deflation → de-leveraging → credit crunch

**Financial crisis → Real economy contraction**

**Real economy vector** (including vicious circle):

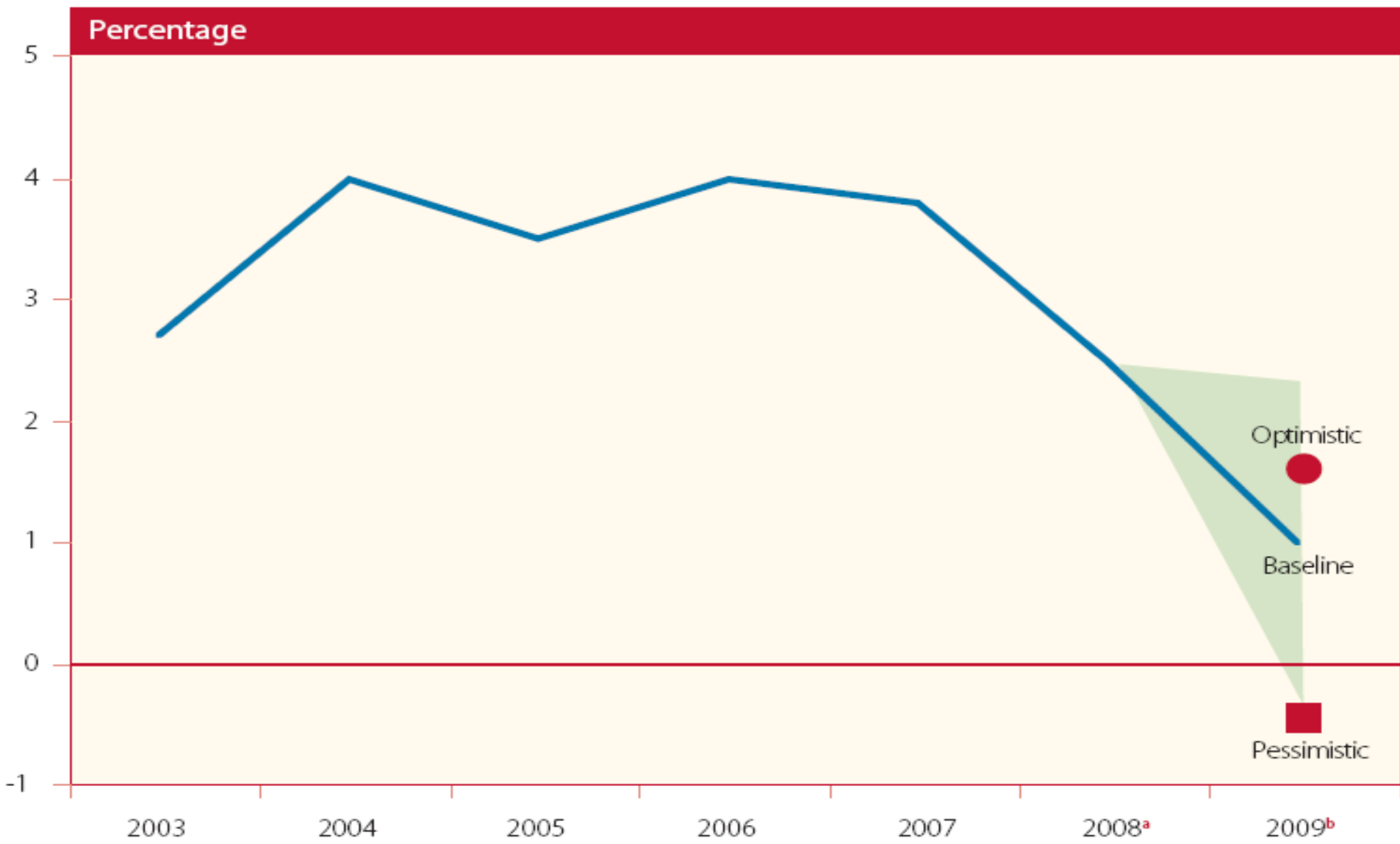
- Less investment
- Less consumption
  - Reduced demand for imports, i.e. for exports of others
  - Prices, output decline
  - Growth, employment decline

# Major Consequences

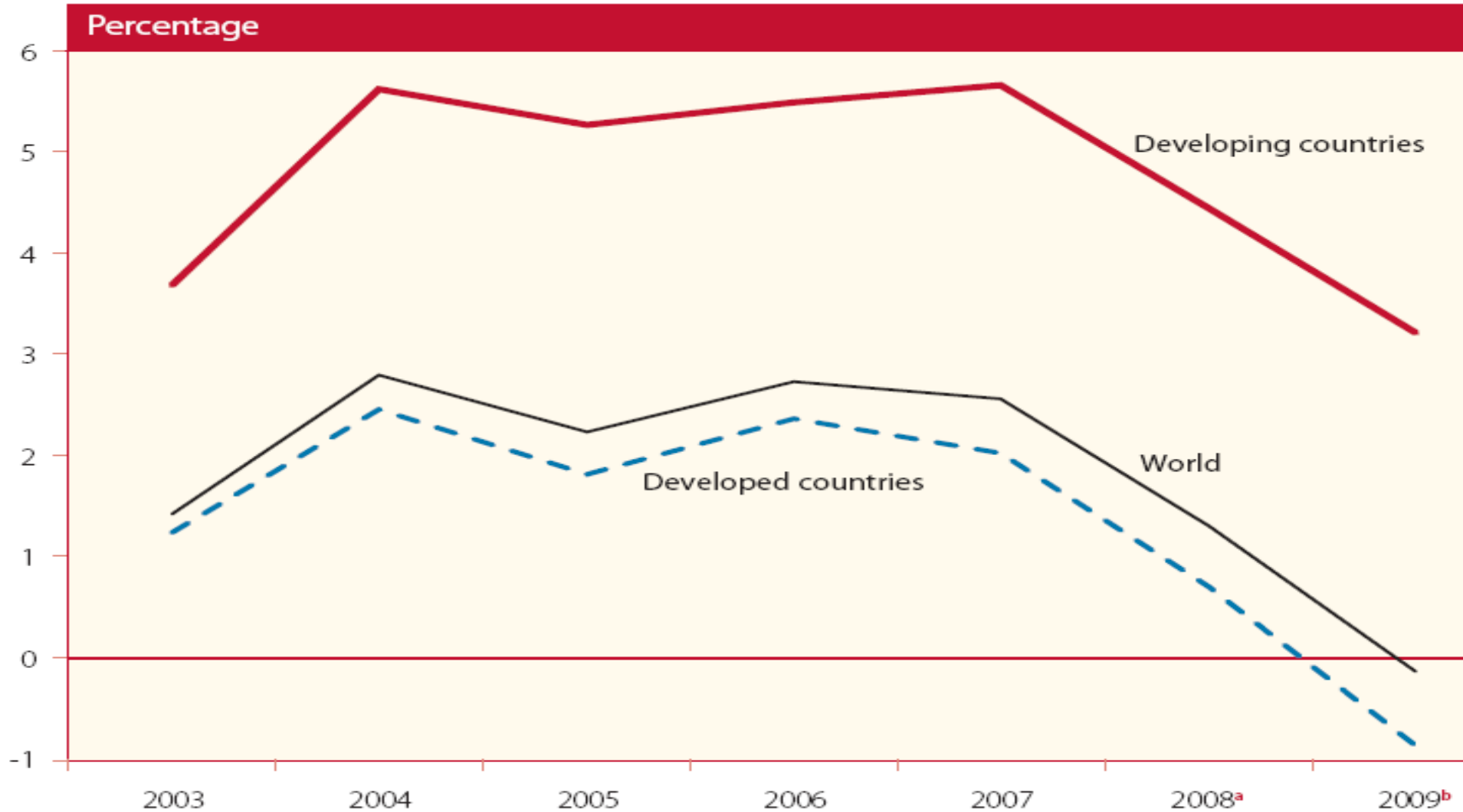


- Emerging stock markets drop  
→ negative wealth effect
- Bank lending growth down
- Foreign demand → commodity prices
- Contracting export markets
- Domestic demand down too
- Employment, incomes, demand lower
- Domestic investments down
- FDI slow down

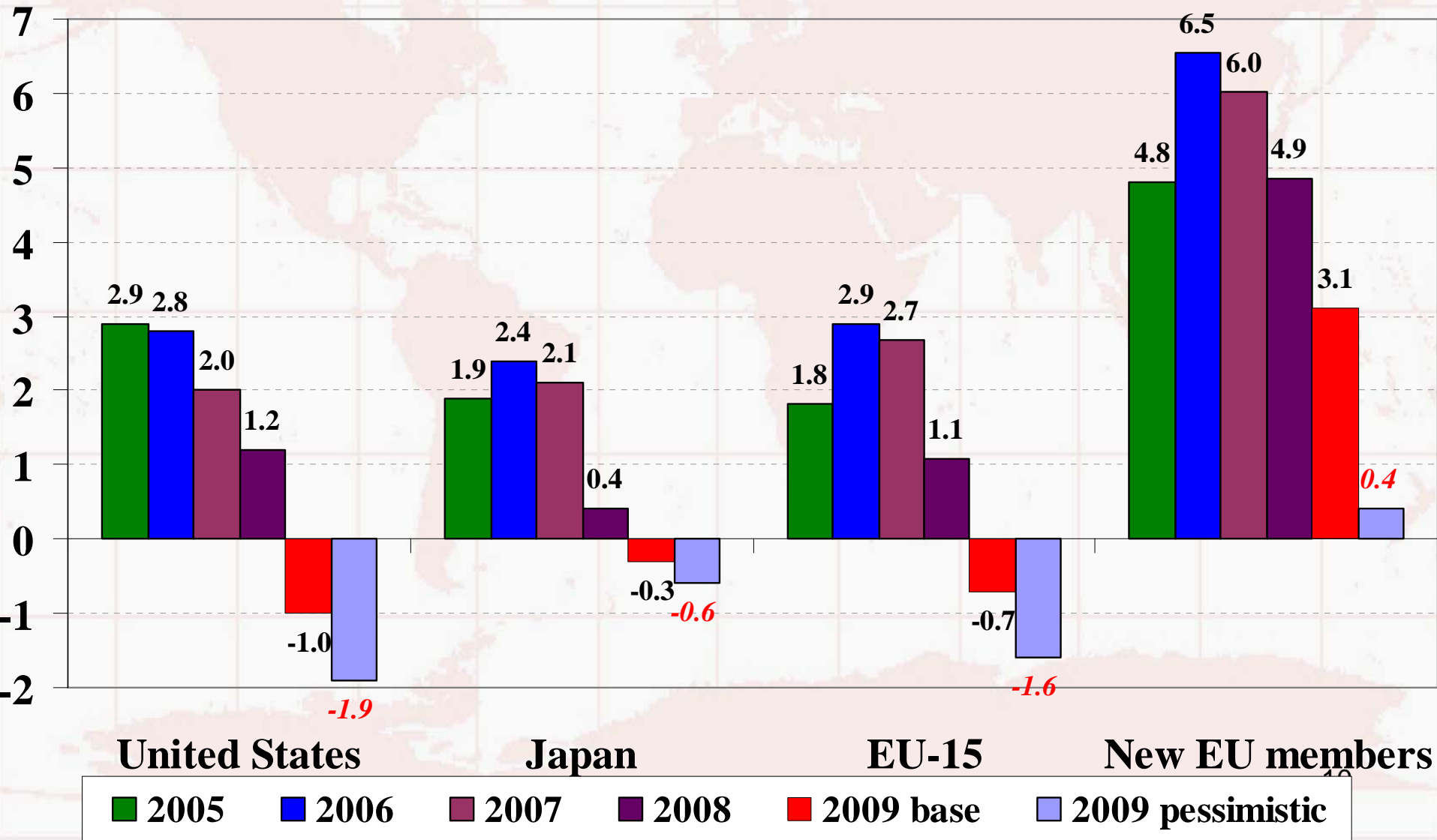
# World economy in recession



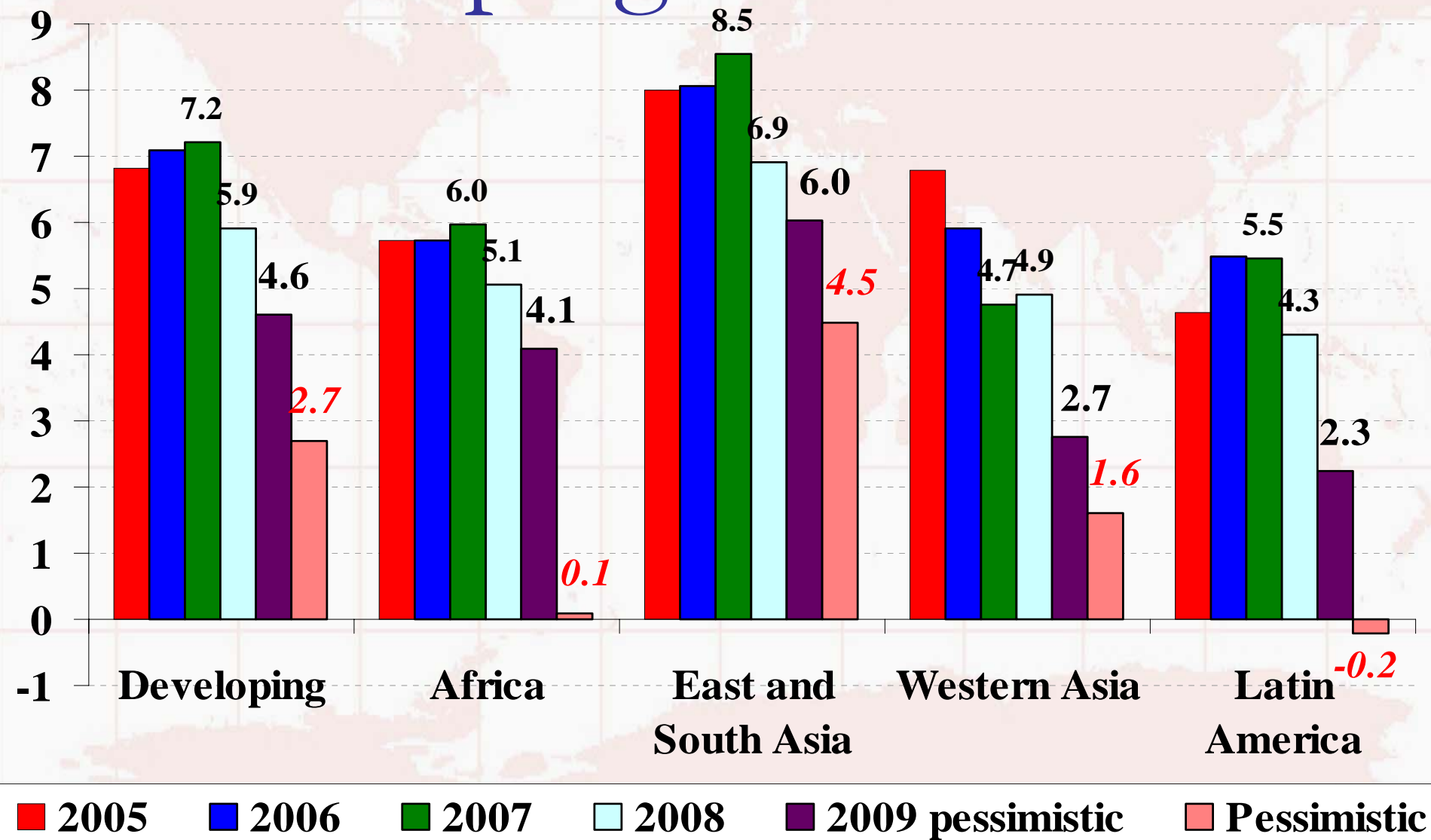
# Globalization: Parallel fates



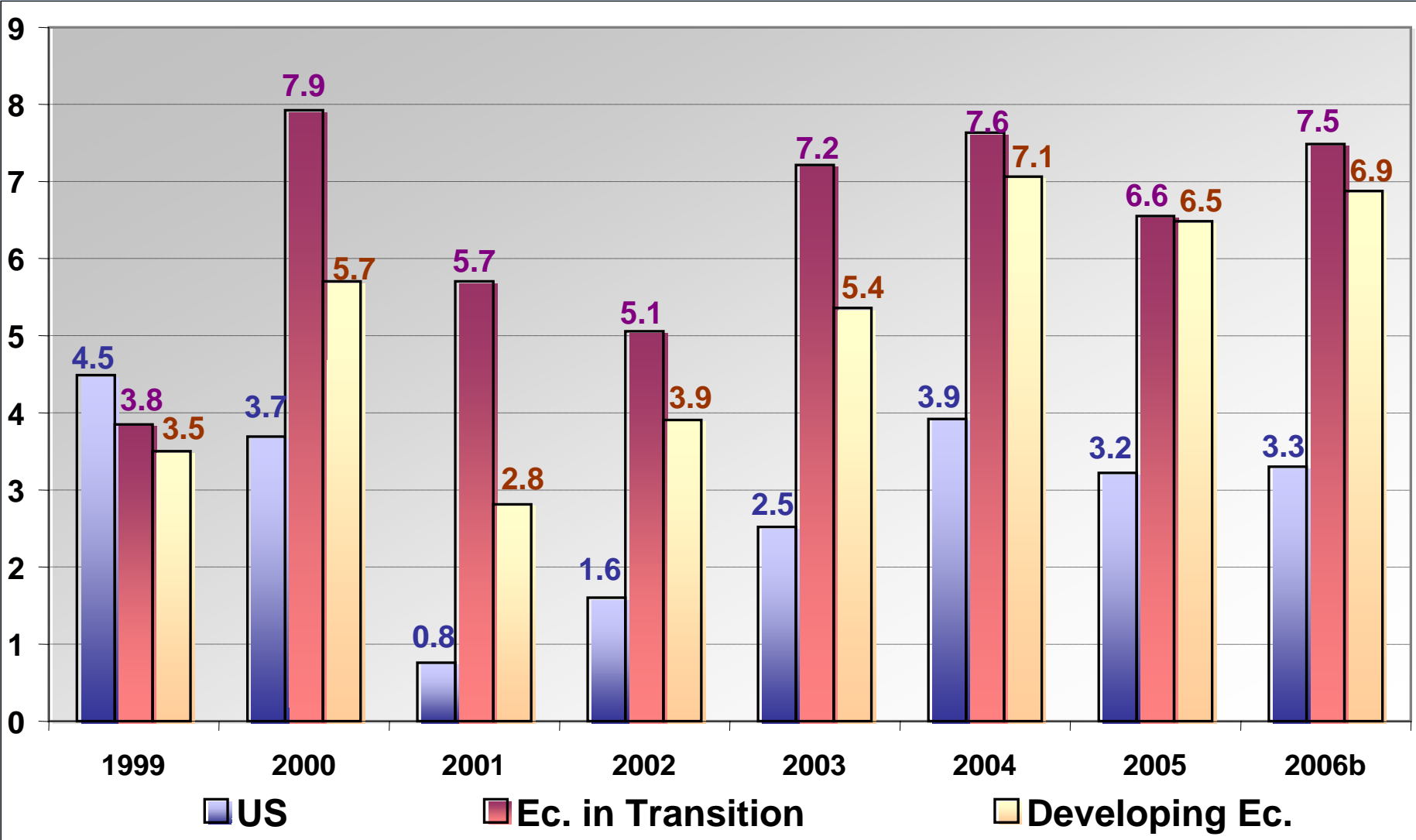
# Recession in most developed economies



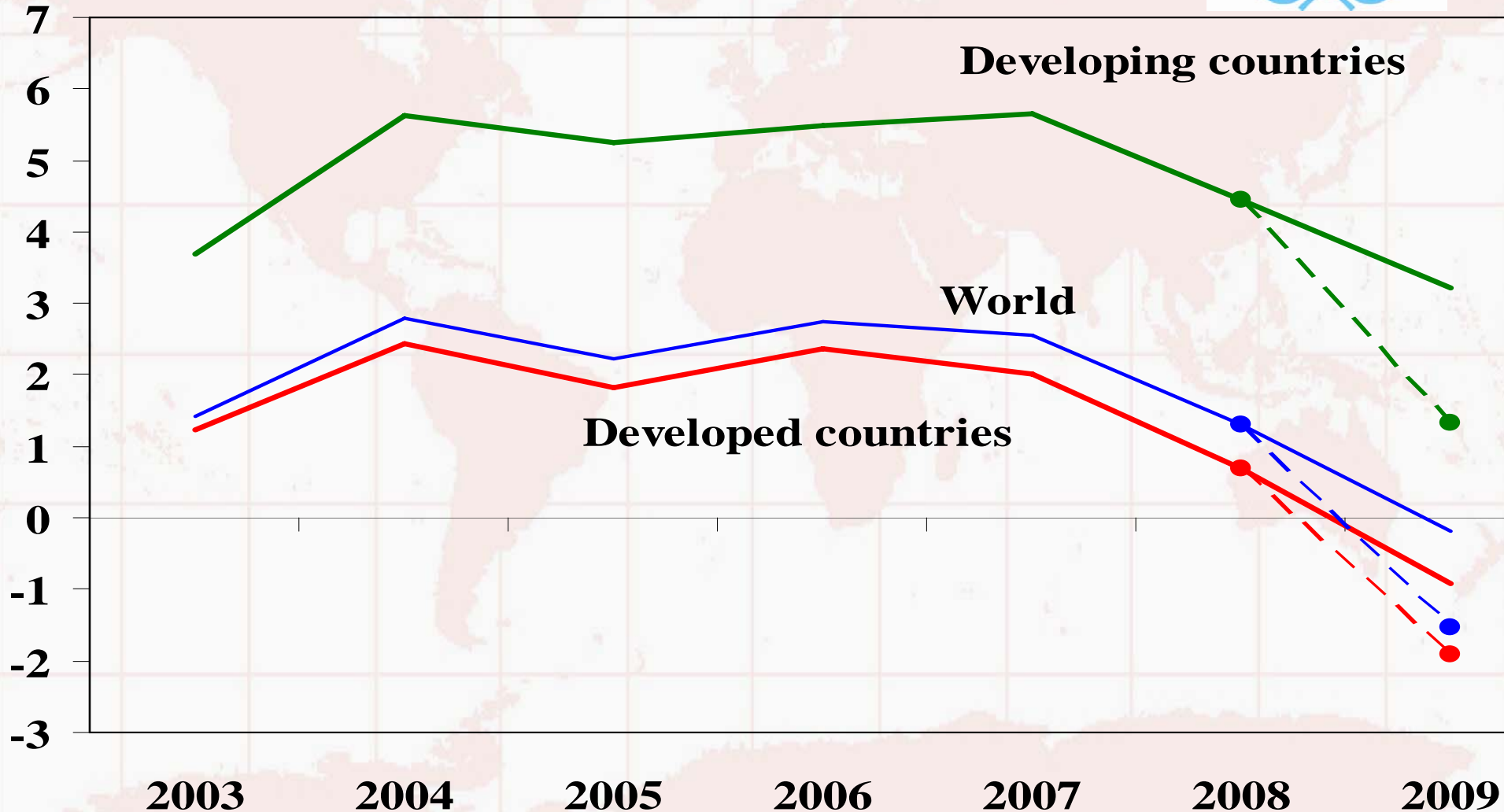
# Slowing growth in all developing countries



# Synchronous growth: The US, transition & developing countries



# World income per capita will decline in 2009



Dashed lines represent pessimistic scenario

# Financial Impacts



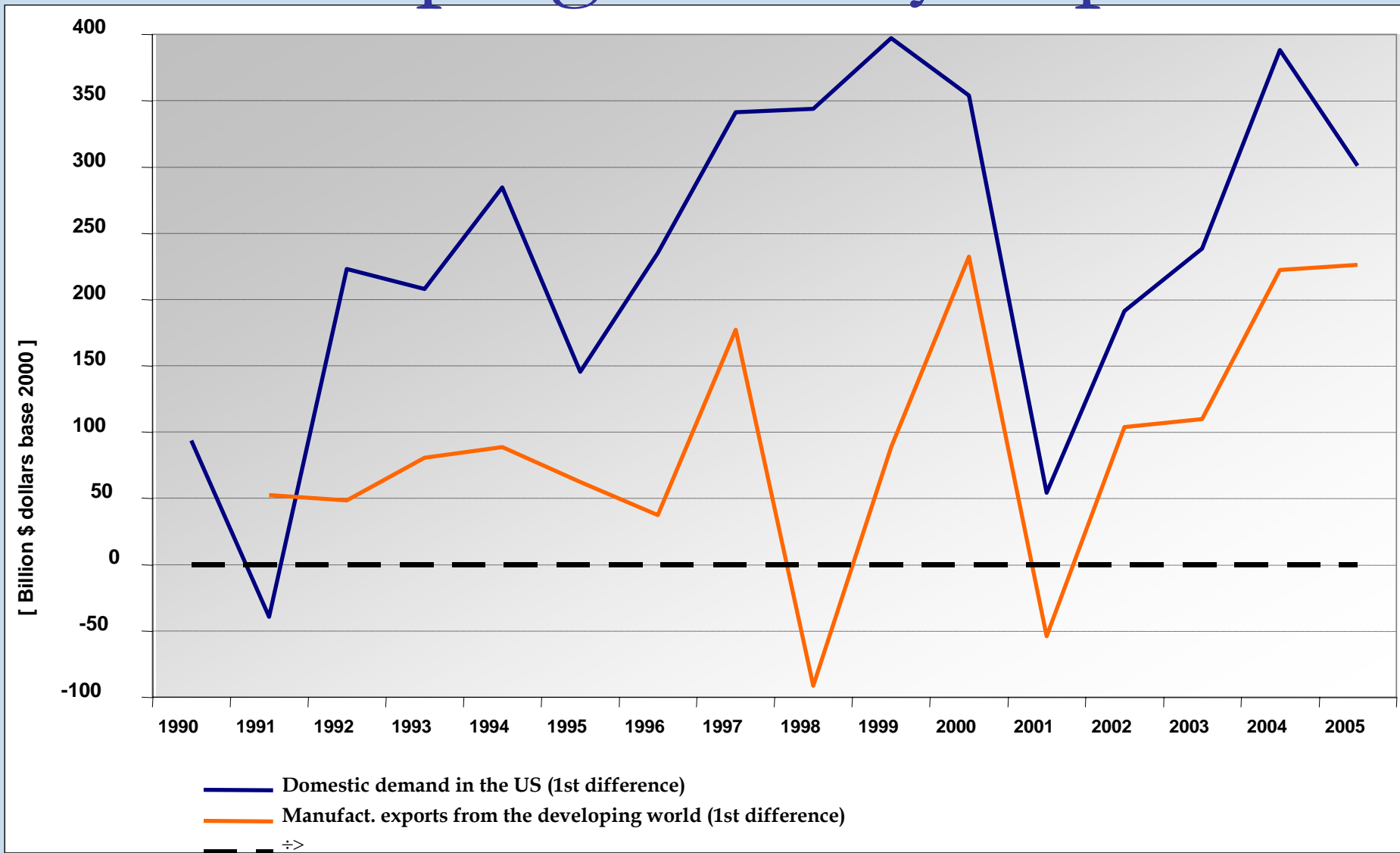
- Financial markets crisis →  
**emerging markets collapse greater**
- **Reversal of capital flows**
- **FDI down**
- **Borrowing costs, margins much higher**
- Financial positions of many developing countries **much stronger** than during financial crises in Asia + LA, due to strong foreign reserves, better fiscal balances

# Trade impacts

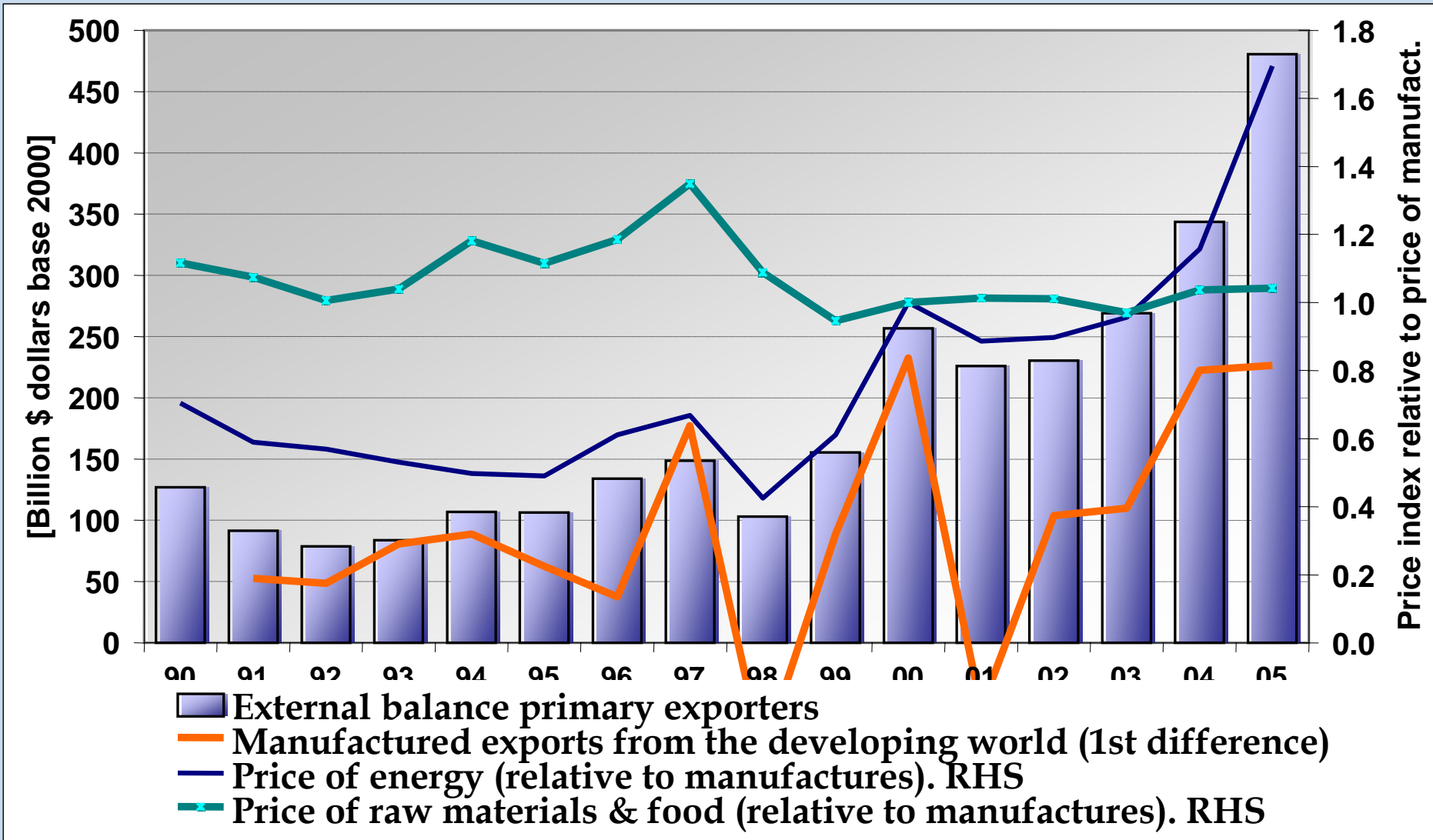


- Exports decline: **all developing countries**
- Terms of trade: **primary exporters**
- **Trade surpluses,**  
**reserves** may run down quickly
- **Lower energy, food prices →**  
**net food and oil-importers**

# Strong US demand lifted developing country exports



# Manufacturing demand supported high primary commodity prices

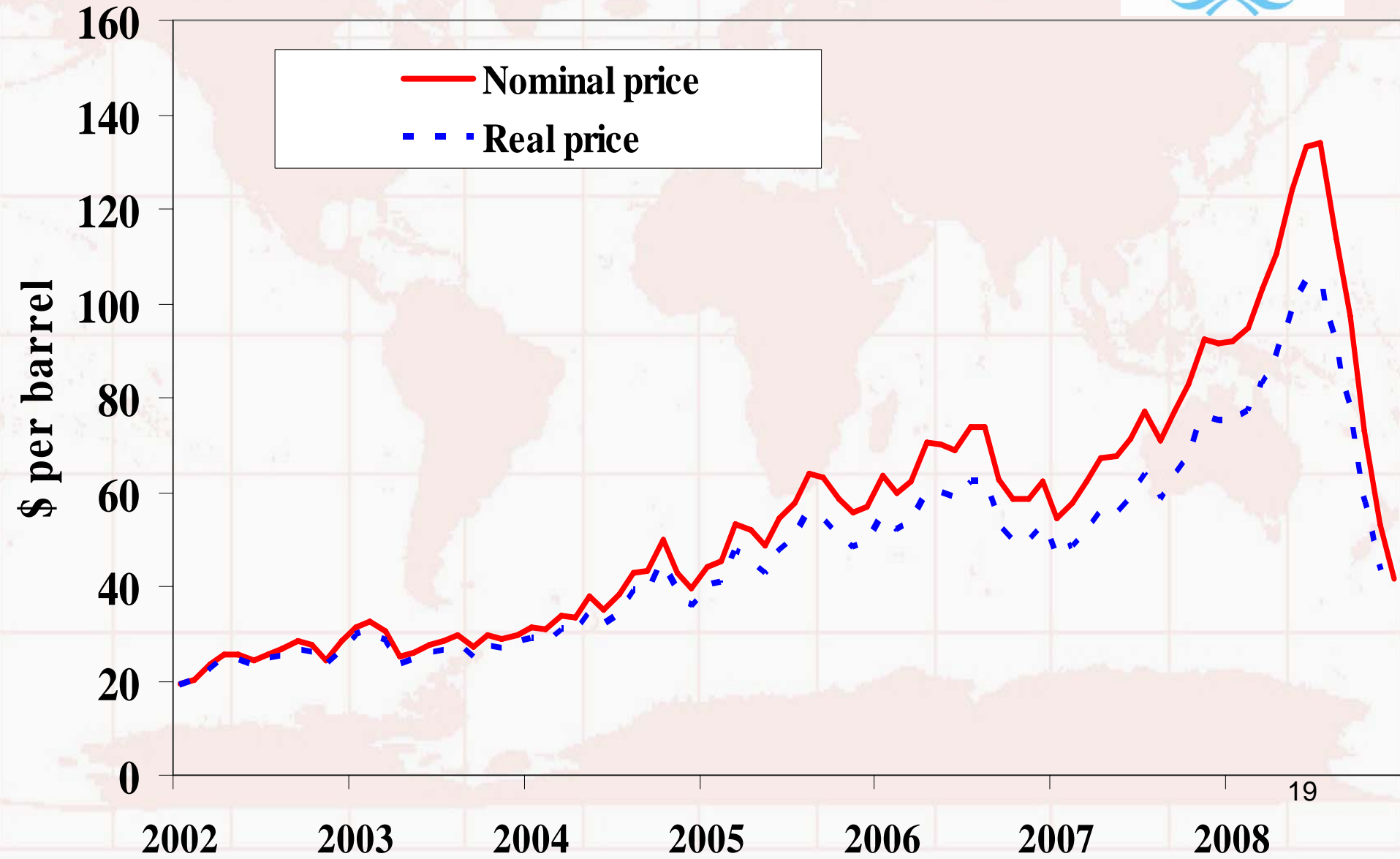


# High commodity prices over

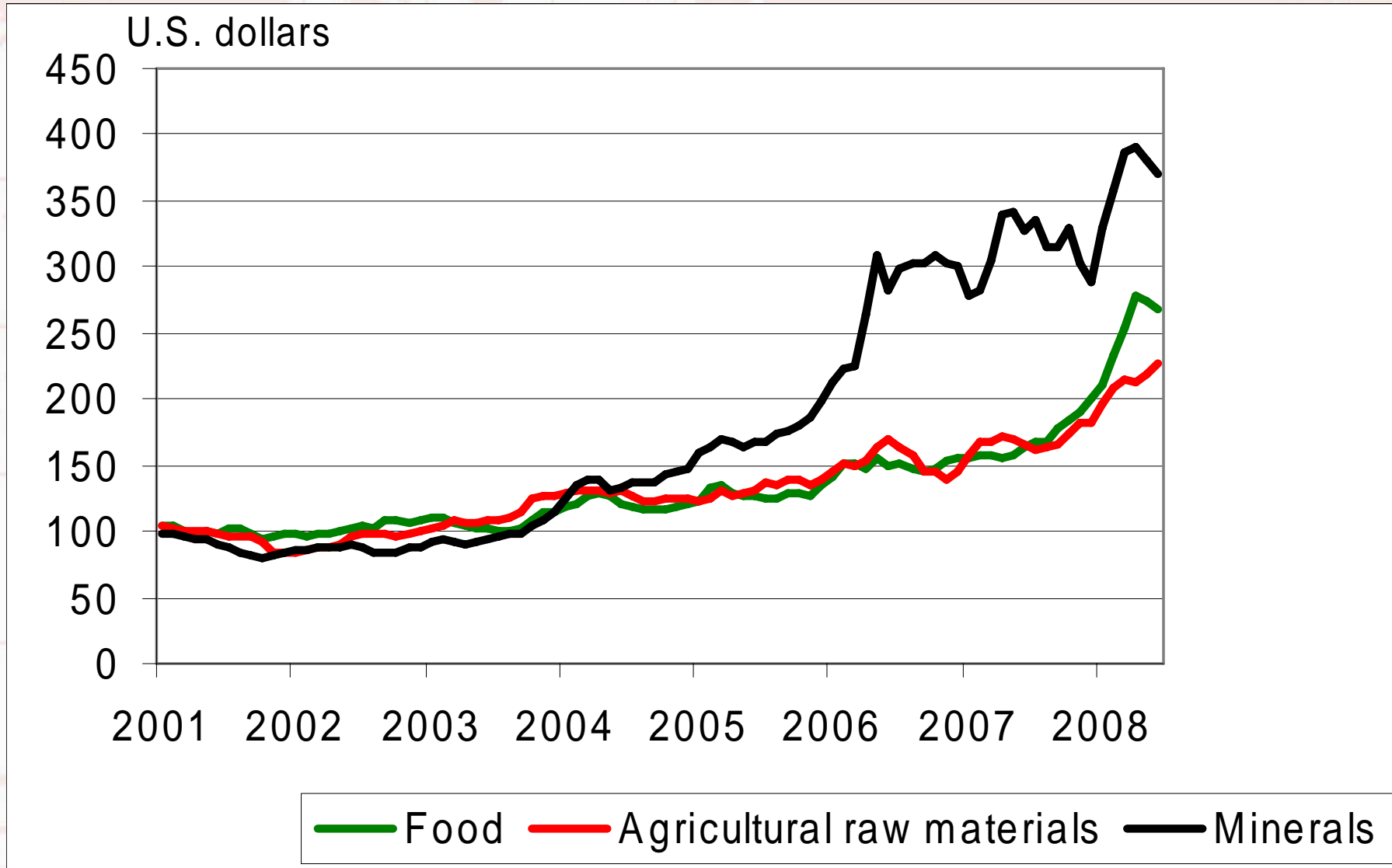


- Last 5 years rare opportunity for many developing countries – including LDCs – to generate substantial financial resources from higher primary commodity exports for investments and growth – *largely over*
- 2008 price spikes for energy and food due to speculation following flight from ‘Wall Street’ (finance) to ‘Chicago’ (commodity futures), other factors

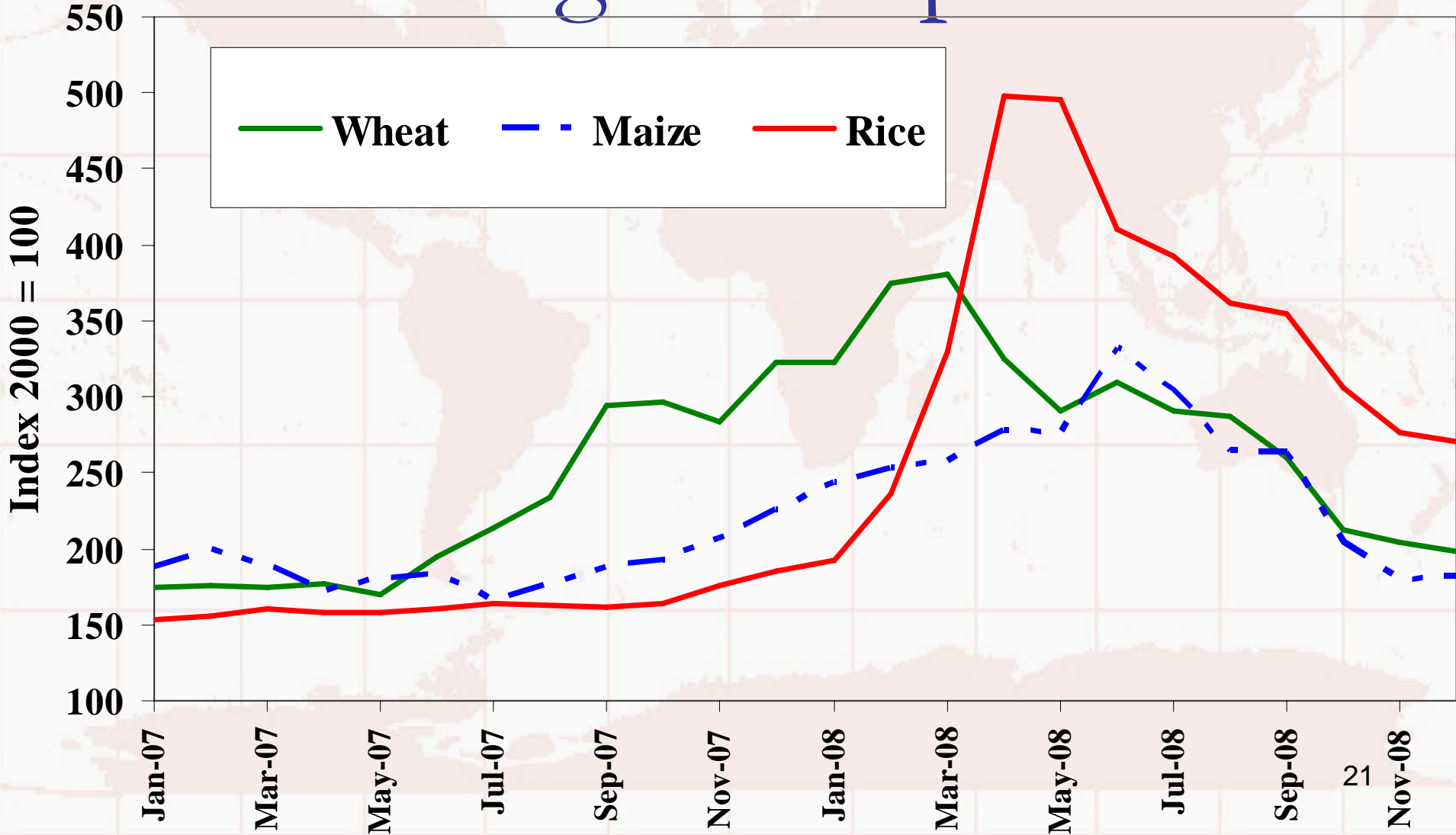
# Oil prices roller-coaster



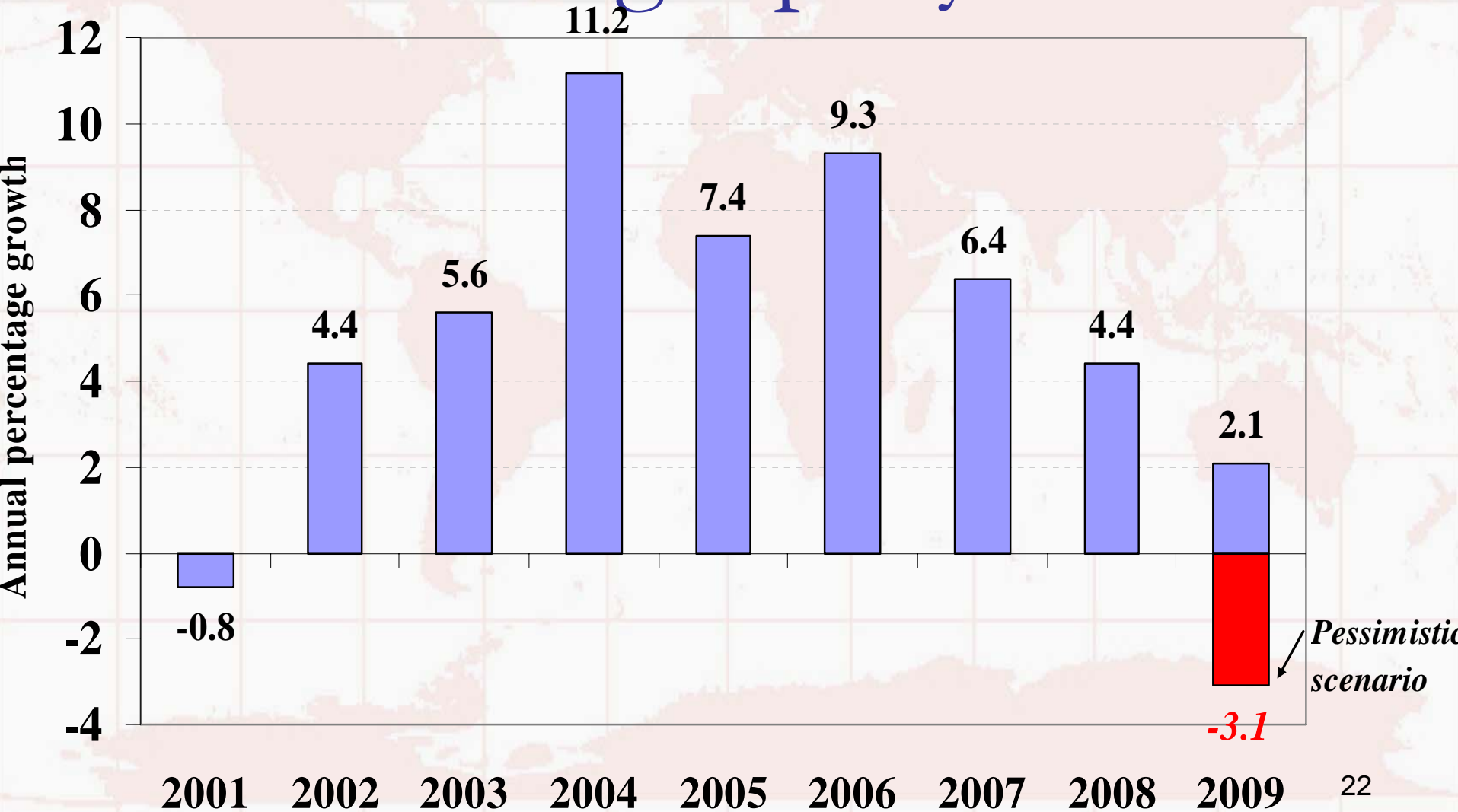
# Non-oil commodity prices



# World food prices declining after spikes



# World trade growth decelerating rapidly



# East Asia Export Implosion



*Dec. 2008 exports year-on-year*

	%
Japan	-35.0
China	-2.8
S Korea	-17.4
Thailand	-15.7
Singapore	-20.0
Taiwan (Province of China)	-41.9
Malaysia	-4.9 (Nov.)

# Crisis policy priorities



- ***Limit spread of financial crisis***
  - Across borders (contagion)
  - To real economy (ensuring liquidity)
- ***Reflate economy***
  - Fiscal measures (fiscal space needed)
  - Monetary measures (monetary space)
- ***Appropriate regulatory reform***
  - National
  - International

# Financial regulation



- Prudential risk management, including capital controls
- Counter-cyclical: limit pro-cyclicality
- Finance growth (output, employment)
- Development finance: Support investment + technology policies
- Inclusive finance

# Domestic demand



- Need fiscal stimulus to offset lower foreign + domestic demand
- Most countries' fiscal space limited
  - need more policy space to cope
- Domestic, not foreign borrowing needed
- Build + improve physical infrastructure
- Strengthen social services, protection

# Social protection counter-cyclical



- Employment crucial,  
especially for poverty reduction
- Fiscal stimulus, esp. for job creation
- Conditional cash/income transfers
- Universal vs targeted social protection
- Incomes → demand maintenance

# Constraints on developing country responses



- Policy, including *fiscal space* constrained
- *IMF requirement* for fiscal stimulus:
  - most countries (including US) not eligible
- *Monetary policy* less effective,
  - worse with independent central banks
- Systemic, institutional, market *pro-cyclicality*
- *Declining aid* likely to worsen

# Crisis response



- UN *WESP* > IMF wrong
- IMF, WB also marginalized
- IMF discouraging fiscal stimulus
- G7 → G20: not inclusive, legitimate, crisis-, but not development-, equity or people-focused
- Stiglitz Commission
- Doha Declaration: summit on impact of crisis on developing countries

# Thank you



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