‘Recovery or Bubble? The Global Economy Today",
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Conference report

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Session 1: Is there a recovery?

The chair of the session, **Jayati Ghosh** (IDEAs and JNU), delivered the welcome address saying that the past two years have seen a lot of financial turbulence with gloomy as well as optimistic predictions about what is going to happen, alternating in their phases. This culminated in a renewed phase of optimism when many believed that things were almost back to normal except for a few hiccups on the issues of bank regulation, business perks and bonuses.

In this conference the attempt is to look a little deeper into the question of how global capitalism is functioning and whether the crisis is over. In other words, the question is whether the crisis has been dealt with adequately or it continues to show signs of deeper structural imbalances that have not yet been resolved. This therefore involves understanding what these structural imbalances are, whether they can at all be resolved, and the implications of the failure to resolve these imbalances, particularly for developing countries where the optimism about recovery is very pronounced (as in India).

The first speaker of the session, **Jan Kregel** (Levy Economics Institute of Bard College), argued that the global economy is very far from any kind of recovery. While the recovery of the sub-prime market in the US, known to be the proximate cause of the global crisis, is unlikely, it is also relatively less important because of its minuscule size in total mortgage and financial market. However, even the recovery of the prime mortgage market is suspect since continual decline in housing prices have resulted in the value of houses becoming lower than that of the outstanding mortgages on the houses. In this situation, therefore, the incentive is to default rather than to pay more than the worth of the property. And as long as house prices continues to fall, the default rate is going to rise even further. Adding to the woes of the mortgage market are the problems of the sharp increase in unemployment, especially underemployment in the US economy, and increasing resistance on the part of state governments to extend unemployment benefits. Since unlike the federal government, state governments in the US are required to run balanced budgets, the increase in expenditure on account of unemployment benefits have induced resistance in the state governments against continuing unemployment benefits. Discontinuation of unemployment benefits is going to further raise default rates, destabilise housing prices and stall recovery.

Even the commercial real estate market, consisting of big and retail real estate markets, is unlikely to recover anytime soon. Retail real estate markets, which are financed by small and medium banks, have been facing closures because of fall in consumer demand and turnover. The closure of small businesses show up as bad loans on the books of the small banks, and has led to closure of numerous such banks. While the big banks financing the larger real estate markets have been less affected, it has been mainly because of ‘rollover’ of loans by these banks. However, as this cannot continue endlessly, sooner or later even the big banks are likely to be affected. The added dimension of the closure of small and medium banks is that it impacts the smaller urban areas, and makes generation of fiscal revenue all the more difficult. Fall in state government revenues implies further cuts in their expenditures for maintaining balanced budget. That, in turn, has a dynamic impact of reducing income of state government employees and hence tax revenues earned by the states.

The collapse of the mortgage market therefore produces a generalised decline in demand. The net result is that the benefits of the supposedly large federal stimulus package are also reduced. And since most of the expenditures under the federal stimulus bill would be exhausted by the middle of the current year, then, in effect, all that the fiscal stimulus has managed to do is prevent the continuation of the decline of the level of income and unemployment. At the overall level, therefore, there is no indication of recovery and it is unlikely that the US would return to its earlier state of being the source of world demand. Regarding other parts of the world offsetting the fall in US demand, the problem is that the EU has historically never been able to provide an offset fall in US domestic demand, while the Japanese economy is dependent on demand coming from China and other East Asian economies. China too is unlikely to offset US’s decline in demand as it is a net exporter and will not anytime soon shift to becoming a net importer. In so far as emerging markets are concerned, these have been experiencing domestic expansion because of reliance on trade, and hence their growth is sustainable only when global economy grows alongside.

In the next presentation, **Arturo O’Connell** (Central Bank of Argentine Republic) too discussed the basic features of the current recovery and its limitations. He argued that the recovery being experienced now is unlikely to be sustained as a large part of the recovery is based on specific stimulus packages that are likely to come to an end soon. This is likely to be hastened by the pressure put on by the accumulation of large government debts, on the one hand, and extraordinary expansion of balance sheets of central banks (to support the financial sector), on the other, in the major countries.

Significantly, in spite of bailouts for big banks in the advanced countries there is little sign of increase in demand for credit. Thus even though banks might be willing to increase their lending, demand hasn’t increased. Although there has been some recovery of other financial markets in the second half of 2009 (like the stock markets), the net figure of finance coming from banks and other markets is still negative. Thus despite the recovery, the volume of finance available now is lower than that before the crisis.

Tackling the crisis requires understanding the factors responsible for generating it. While many emphasise ‘global imbalances’ as the major cause, it is actually the extraordinary imbalances in the financial sectors in the US and UK - because of extremely high leverage, a lax supervisory system and increasing interconnectedness of financial markets after the repeal of Glass-Steagall Act in the US - that are the major factors. In addition, with the process of increasing securitisation, which made the whole financial system extremely interconnected, the crisis emanating from the sub-prime market (even though small in size) spread to other parts of the market.

While there are discussions about measures like reducing leverage, imposing liquidity requirements etc., needed for tackling the situation, these are likely to be applied only in 2012, if at all. In effect, all the financial fragilities that were in the system and led to the crisis – global imbalances and problems with the way in which the financial system was being allowed to work with high amount of risk - are not being worked at as it should have been.

Thus while the global system suffers from limitations to recovery, the measures to deal with the fragilities of the financial system that affect the real economy (like regulation of the credit rating agencies, regulation of derivatives), have either completely disappeared from discussions or are faced with enormous resistance. Even the measures that have not disappeared from the ongoing discussions are being postponed under prolonged consultation processes. No doubt, arguments to the effect that introduction of stringent regulations now would further lower the already mild demand for credit, have some merit. However, that the lobbying power of the financial sector remains strong and that banks that have been showing high profitability in the last quarter in the US are now involved in even riskier activities, implies that little has changed in the financial system. This also seems to suggest that we are heading for another, much worse, financial crisis. Perhaps the second crisis, which is likely to be even more difficult to deal with, would bring the required changes in regulations.

Focusing on the possibilities of a recovery in the European Union, in particular Eastern European countries, **Rainer Kattel** (Tallinn University of Technology) observed that the prevalent view in the EU is that since the crises was created in the US, the only thing needed would be to ride it out and continue as before once the crisis was resolved. The other view, and perhaps the more correct view, is that because of the enormous economic and structural imbalances like the housing bubbles and current account deficits in various eurozone countries like Spain, Greece, Baltic economies and Europe could soon become the centre of the next financial crisis.

In fact, two key phenomena - the common currency in Europe, the Euro, and the high weight of Germany in the zone - make the recovery in EU, especially in the peripheries, problematic. Having a common currency means that peripheral countries like Spain, Greece etc., no longer have the possibility of taking recourse to exchange rate corrections (devaluation) to work their way out of the crisis. What makes the situation even worse is countries having to compete with the strongest exporter of the zone, Germany, a country with much higher productivity and stagnating real wage growth.

Even before the crisis began, the same reasons had become the cause of problem for most of the European countries. Barring a few, all other countries had been losing out in terms of exports because of Germany's stagnating wage growth. They had also been losing out in terms of appreciation of their real effective exchange rate. Increasing current account deficits and fiscal deficits had been the fallout in countries like Spain and Greece. In the Eastern European (EE) countries, on the other hand, GDP contraction following the crisis has been more than 10 per cent. The present condition of the EE countries have a lot to do with the adoption of foreign savings-led growth strategy characterised by massive inflow of FDI; huge cross-border lending (in foreign currency) by foreign-owned financial sector; and growing export dependence (up to 80% of GDP) because of greater integration with the production network. Together with neoliberal macro-economic policies, these brought about an environment of procyclicality, averse to any kind of government intervention in these economies. This particular growth strategy led to transformation of the banking sector, very high level of foreign currency lending to the households in mortgages, and severing of linkages between the real sector and the domestic banking sector. In addition, lagging productivity because of low value added production and rapid loss of competitiveness through currency appreciation made the Baltic countries into Ponzi schemes as they needed foreign borrowing in one form or the other in order to stay afloat.

Although all these countries received significant fiscal transfers from the EU (without which the state of these countries would have been as bad as Greece's), this has also acted as a disincentive to adopt effective policy changes. It therefore seems as though Germany is exporting its unemployment by keeping its wages low and the periphery is exporting the imbalances to the EU via the fiscal transfers. And these both lead deflationary and recessionary tendencies, especially in the EE because of low safety nets. The need of the hour therefore is to have structural reforms with focus on industrial reforms, but what is being implemented are more of neoliberal policies. And for the eurozone to continue there is a need for it to become a federal state instead of a union of independent states with most trying to free ride the union and the fiscal transfers being too weak to correct the imbalances within the EU.

The presentations were followed by two rounds of discussions, covering a wide range of topical issues. **K. Sai Baba** (Delhi University) queried whether compared to Reagan economics, US president Obama's policies had the possibilities of favouring public oriented spending rather than spending for militarization. Referring to Arturo O'Connell's presentation, **Gabriel Palma** (University of Cambridge) commented that more than the lack of demand for credit, the problem was one of supply-demand mismatch, with banks being mainly interested in lending to big corporations, even when small and medium sized companies, desperately in need of credit, are overlooked. This in turn has also played a role in slowing down recovery and creating further unemployment. Based on the evidence of world wealth losses in multiples of the actual sub-prime mortgage problem and capitalisation being in multiples of the new money flowing into the stock market in the recent period, he said that the foundation of the financial market was and still remains extraordinarily precarious. To Jan Kregel, he enquired whether the Obama recovery plan - in particular given that only a small portion has actually been spent and that even less was spent on infrastructure investment or for environment - was responsible for the weak recovery. **Kasturi Das** (RIS) asked about the implications of Obama's move to introduce tax disincentives for US companies resorting to outsourcing, on cost competitiveness of US private sector, overall revival of the US economy and the countries at the receiving end. Also, she wanted to know if it is possible for the US to increase exports as has been announced by Obama and the target markets for it.

Ramgopal Agarwal (RIS) queried about the possibility of a dollar crisis as this could lead to a crisis far worse than that being witnessed now. He also wanted to know the reasons behind the continued faith in neoliberal polices and the prospects of Southern Keynesianism, in the face of inevitable decline in demand from the North. **Shouvik Chakraborty** (Research Scholar, JNU) asked whether the commodity markets would be the next target of finance capitalists to create a bubble and feed off it for profits.

Responding to the issues of comparison between the Reagan recovery and the current direction of spending in the US and recovery in developing countries, **Jan Kregel** pointed out that the present condition is very similar to the petroleum crisis of the 1970s which also created excess global liquidity. At that time, banks had channelled the excess liquidity to Latin America. While this created substantial amount of indebtedness in these countries, it also produced expansion. In response, policies meant to dampen it (like raising interest rates) were adopted which further reinforced the attractiveness of these markets. But soon after the initial euphoria, with the change in US policy, these developing markets collapsed. Currently, the developing countries are facing a similar situation: India, for instance, has been witnessing a sharp surge in capital inflows. This, coupled with expansion in the private domestic economy is likely to force central banks to raise interest rates and thereby further increase the interest rate differential. All this creates incentives for massive currency mismatches in corporate finances and lays the base for precisely the kind of crisis witnessed in the 1970s. One therefore needs to be careful about the degree of decoupling of the emerging markets from the developed world and hence the sustainability of recovery in them. With respect to the issue of Obama's move to increase exports and reduce outsourcing, Jan Kregel pointed out that the rise in the share of profits in the US at present, to the peaks reached in the 1960s, had been made possible by increasing outsourcing. Trying to reduce outsourcing would effectively mean de-globalising, which is not possible. Further, outsourcing was also the main reason for increase in labour productivity in the US during the 1990s. Reduction in outsourcing, which would further impinge on US's export competitiveness, cannot be balanced by wage cuts since that would have negative repercussions for demand. Exchange rate manipulations also are not a viable option. Coming to the question of possibility of a dollar crisis, he argued that it is unlikely since converting into an alternative currency, like the Euro would appreciate and aggravate EU's competitiveness problem while the Chinese currency was far too regulated for that to be possible. Regarding the continued predominance of the Washington Consensus, he said that as long as the financial system dominates, the objective of it would also be to ensure loans are repaid, as the survival of the system depends on validating those loans. Since the Washington Consensus policies are the only way to ensure this, these policies continue to dominate.

Arturo O'Connell, in his response, said that he agreed with the point that there exists segmentation in bank lending whereby small and medium sized firms were unable to have access to credit. And the same holds true for the agricultural sector, especially small farms.

Regarding the point as to how the small sized sub-prime mortgage crisis became a full-blown crisis, he said that increased connectivity between the domestic and international financial markets was responsible for that. He contended that the recovery of the financial sector's power of lobbying and the intellectual capture of the regulators as well as lack of any consistent model in economics that links macroeconomics with the financial structure lay at the root of the continued belief in neoliberal policies.

Rainer Kattel, answered that the continuing faith in neoliberal ideology can be explained, at least in the case of the East European economies, by the lack of any independent tradition of alternative, heterodox thinking.

In the second round of discussions, **Surajit Mazumdar** (ISID) queried about the possibility of China reducing its dependence on the US for demand and in the process becoming an important source of demand for other developing countries many of which run current account surpluses with China. He also asked whether it is possible to have a second round of crisis, as argued by Arturo O'Connell, without it being preceded by a boom like the current crisis was preceded by one. Regarding EE countries, he queried about the mechanism by which the common currency restricts the ability of European governments to respond to the crisis.

Amarjyoti Mahanta (Research Scholar, JNU) raised the point that a stimulus package that increases consumption rather than investment in a consumption-oriented economy like the US, is bound to be relatively ineffective because of leakages (e.g. through increased imports). **Shreetama Ghosh** (student, JNU) commented that China not being able to become the alternative engine of growth is more a reflection of US's political hegemony. **Krishna Kumar** (Delhi University) queried about the role that unification with East Germany played in explaining the stagnation of real wages in Germany.

Jayati Ghosh asked about the reasons for the irrational exuberance in the financial markets and possibilities of gold acting as the alternative to Euro or other currencies in the event of a dollar crisis. To Arturo O'Connell, she asked about the possibilities of having domestic regulation given that financial markets are highly interconnected. To Rainer Kattel, she asked whether the EE countries' experience reconfirms the fact that a unification based on money alone without a common state is not possible.

Jan Kregel responded by saying that China can shift from dependence on exports and generate more domestic demand, but for it to be sustainable, it has to be self-generating. Also, income levels have to be sufficiently high, which is not true about the Chinese economy as its domestic demand still remains very low. He also clarified that although China does have a strong currency, there is not enough of it and the Chinese GDP is not sufficiently large to be able to offset the decline in the demand from the US.

Regarding the US stimulus package, he said that it was meant to mainly increase investment and only tax reduction was supposed to boost consumption. However, this is likely to fail because tax reductions have differential impact on consumption and with the decline in the income of a substantial portion of the population, this would not help increase demand. In this context he pointed out that Minsky's solution of boosting consumption rather than investment for sustained expansion without building financial fragility was fine only in a world which did not have finance-driven consumption, as this also creates (like investment) financial assets which leads to financial layering and potential financial fragility.

He concluded on the note that financial markets are not being irrational since they believe that the restoration of the financial system would lead to restoration of lending, and then restoration and recovery in the rest of the financial system. The difficulty with this argument, however, is that in the current situation, while the banks are fine with holding liquid money, an investment advisor cannot afford to do so for fear of losing income and even his job. That is why one sees a rush to invest in emerging markets. Further, he added, buying gold is a good alternative for averting a dollar crisis as it helps take the pressure off the dollar-exchange rate.

To the query on the possibility of another crisis without it being preceded by a boom, **Arturo O'Connell** answered that the boom is here as is reflected in the booming stock market, banks registering profits, flow of capital to the emerging markets etc. Regarding the possibility of national regulation for financial system given the high connectivity owing to international network build-up, he contended that while there should be some minimal standards of regulation at the international level, most of financial and banking regulation should be left to national authorities. Further, in the case of developing countries there should be additional specific regulations which might not be as important for advanced countries, especially the ones with strong currency. The regulation for developing countries should include issues regarding currency mismatches, capital controls on both inflows to begin with and outflows.

Speaking about the problem of managing the economy because of the currency union, **Rainer Kattel** said that since most of the EE countries have to adhere to the Maastricht criteria which require budget deficits to be limited to 3 per cent of GDP, and which prohibits devaluation of the currency, it leaves little by way of policy space for these countries. Regarding the issue of viability of the EU given that it is mainly a monetary union of separate states, he said that while there is little economic sense in the Euro, there is a lot of political backing for it. However, it is unlikely that the EU would grow any further.

Session II: Global imbalances

The second session of the day, chaired by **Abhijit Sen** (JNU & Planning Commission), commenced with a presentation by **Terry McKinley** (Centre for Development Policy and Research, SOAS, London University) on *The US-China Marriage of Convenience: Prospects for global imbalances and economic recovery*. He addressed the issue of US-China relationship in the context of global imbalances, in particular the debate as to which of the countries - the US or China - is to be blamed for global imbalances and the role played by global imbalances in the financial crisis and the recovery from it. He argued that the reason why China is often blamed for the financial imbalances is because of its policy of manipulating the exchange rate to accumulate a gigantic current account surplus. According to him, the main source of the global financial crisis was located in the United States which had been spending beyond its means - based on borrowing from abroad - for a very long time and not the excessive savings of the Chinese economy. He argued that going by the accounting definition that total world savings must be equal to the global investment, excess of savings in one part of world, such as Asia, must necessarily be balanced by deficient savings in other parts of the world say the United States. Also the figures on global savings and income did not provide any evidence of global saving glut, as the ratio of global saving to income has remained stable at 22-23% since the late 1980s.

Speaking on the issue of the current global economic instability, Terry McKinley highlighted that the US stimulus package, which replaced its huge private spending with massive government deficit, thereby taking the US fiscal deficit to around 12.5% in 2009, would tend to enlarge the current account deficit. The alternative way of stimulating the US economy through devaluation of the US dollar would have made exports cheaper and reduced the current account deficit. However, devaluation of the US dollar, he argued, would have resulted in appreciation of the currencies of many other countries and hence worsened their trade balances, even when the relative value of US external debt would have been lower and the value of its assets abroad higher. Either way, the US still remains in the driver's seat as it has the privilege of effectively inflating its external debt by printing more dollars, and the countries holding their reserves in US Treasury Securities will have to bear the loss of asset value.

Tracing the movement of the US dollar, Terry McKinley showed that there has been a secular decline in the dollar value from 2002 to mid-2008. This phenomenal depreciation of the dollar coincided with the ballooning of the US current account deficit and the situation continued to worsen. While, in a curious development, in mid-2008, the dollar appreciated because of the impending crisis, very recently, the dollar has again depreciated. The problem that the United States, China and the world in general, have, he pointed out, is that the dollar needs to depreciate to reduce the global imbalances but the reserve currency status of the dollar impedes this adjustment. If the depreciation of the US dollar goes too far and too fast, the interest rates on US securities will have to rise to compensate foreign investors in its securities. This will choke off a US recovery. If, on the other hand, China reduces its holdings of treasury securities, the US dollar will depreciate faster and the situation will become more dangerous.

In this context, he pointed out that the argument put forward by the western critics that China should boost domestic consumption, and thus imports, to rebalance its own as well as the global economy is also problematic. Although it is feasible for China to rebalance its growth model by stimulating more domestic consumption given its large domestic market, China continues to rely on the policy of increasing its exports as an engine for increasing productivity and growth. Since China's trade is becoming increasingly diversified and less reliant on exports to the US, it has the option of pegging the value of the *renminbi* to a more diversified set of major currencies. But it is more lucrative for China to peg its currency against the dollar because otherwise the book value of the dollar-denominated assets will depreciate with the depreciation of the dollar. Further, he argued that in the present scenario the US dollar is not a reliable store of value. Due to the impending depreciation of the dollar, doubts have arisen about the dollar remaining the prime currency. While the large and increasing current account deficit of the United States, along with countercyclical monetary and fiscal policies of her government, has again reduced the problem to how far the US dollar would depreciate, it has also increased the instability. Amidst such inherently unstable global order, he argued, any threat of withdrawal of Chinese dollar-denominated investments will further add to the instability.

The next speaker, **Prabhat Patnaik** (Kerala State Planning Board and JNU), focused on the topic of the diffusion of manufacturing activities from the advanced capitalist economies, mainly the US, initially to the East Asian countries, subsequently to the South-East Asian countries, and more recently to China and India. He underscored that the diffusion of activities from the "core" to India and China is akin to the Lewis's model of economic development "with unlimited supplies of labour" because the two countries are considered to be the repositories of labour reserves. However, the current situation is different from the Lewis model in a sense that Lewis did not consider the impact of productivity growth that is now associated with the diffusion-receiving economies like China and India. The rapid rate of technological progress in the diffusion-receiving economies has the impact of truncating the labour absorbing capacity of the growth process and hence prevents labour reserves from diminishing. This in turn, Prabhat Patnaik contended, has several implications. First, as a result of high productivity growth, wage rate in the modern sector of the diffusion-receiving economies of the world remains at the subsistence level. And typically the wage rate in the modern sector which employs skilled labour is much higher than that of the unskilled labour. Further, constantly rising productivity ensures that this subsistence level remains unchanged as long as labour reserves remain undiminished. Second, there is a rise in the share of surplus in the "modern" sector, in the diffusion-receiving economies (and hence by implication in the entire "modern sector" of the world, i.e. taking both the "core" and the diffusion-receiving economies together) because wage rates does not rise in commensuration with the rise in productivity. It therefore follows that an increase in income inequalities is intrinsic in the dynamics of the growth process in diffusion-receiving economies. Further, he argued, the wage rate would remain stuck at the subsistence level even after the entire labour reserves of the diffusion-receiving countries are exhausted. This is owing to the fact that developing countries are competing against each other for diffusion of activities and would avoid increase in the wages that could lead to a shift of activities to other labour-surplus economies. The third implication is that the rise in the share of the surplus in the modern sector's output over time would create an *ex ante* tendency towards under-consumption. The effect of this *ex ante* tendency is to produce an *ex post* realization crisis at the core itself. This is because in the core, product wage, relative to labour productivity, is higher than in these economies and this reduces the core's ability to compete with these economies in the event of any deficiency of aggregate demand. When *ex ante* savings at the base level of capacity utilization in the world economy exceeds *ex ante* investment, the resultant deficiency in demand leads to a reduction in output. The reduction of output in the core reduces the *ex post* savings in the core which in turn leads to a current account deficit in the core and a corresponding current account surplus in the diffusion-receiving economies. Alternatively, if there is a rise in fiscal deficit in the core as a countervailing measure to prevent realization crisis, this would also increase the current account deficit. Thus, in either case, whether the *ex ante* tendency towards under-consumption is thwarted or realized, it causes an increase in the current account surplus of the diffusion-receiving economy, and a corresponding increase in the current account deficit at the "core". According to Prabhat Patnaik, this view of tendency towards "under-consumption" appears in the "savings glut" hypothesis though in a theoretically distorted form.

He highlighted another trend, the "tendency towards displacement", which also has a similar kind of effect. In this context, he argued that even in a world where there is no technical progress at all and the level of labour productivity and wage shares are given, the very fact of "diffusion of activities" from the "core" would bring about a secular reduction in the level of activity at the "core", and hence a secular increase in the ratio of current deficit to its GDP at the "core". If, in such a world, he argued, there is a boom in the core due to fiscal expansion, it will lead to profit inflation in other countries. This would be accompanied by rise in prices and savings as well as rise in the current account surplus in the diffusion-receiving countries. However, in the event of a slump and consequent reduction in world aggregate demand there would not be any decline in the current account surplus of the diffusion-receiving countries since they remain much more competitive. Therefore the "ratchet effect" would give rise to a displacement of activities at the core relative to the diffusion-receiving countries which is over and above the tendency of "under-consumption".

Explaining the reason for the reluctance of the diffusion-receiving economies to expand domestic absorption, he pointed out that once a country is caught in the trajectory of export-led growth any stepping out of it will be harmful for its interests (just like the Darwinian struggle Marx had talked about). He emphasized that any peaceful transition from the trajectory of export-led growth to greater domestic absorption is not possible without significant political changes. He concluded with two important implications of the foregoing discussion. First, under neoliberalism, poverty and underdevelopment will never disappear because it is associated with the question of labour reserves and subsistence wages. All that will happen is a perpetuation of dualism. The second major implication is that in a world economy characterized by such diffusion, the tendency towards "imbalances" will not disappear. Any change in the regime will be confronted by international finance capital.

The last speaker of the session, **Jomo K. Sundaram** (UN-DESA), began by pointing out that to understand the nature of the global imbalance it is not enough to look at it only in terms of trade alone. In his opinion, militarism needs to be taken into account when looking at the causes of such imbalances. In this context he pointed out that the significant deficit which the US ran before the end of the Bretton Woods system in 1971 and again before the current crisis was associated with the Vietnam War of 1960s and the recent spending of the Bush administration in the war against terror respectively.

Comparing the current downturn with that of the Great Depression of the 1930s, Jomo K. Sundaram underscored that there has been a sharper decline in the stock market now than in the 1930s. However, there is a contrast in terms of output, as in there has been some recovery in output over the last three quarters, even though the sustainability of this recovery is yet to be seen. Also, the current situation is characterised by a collapse of world trade which has important implications for developing countries; this is because a major consequence of globalization has been increased externalization of production in these economies. In this scenario, one of the main challenges faced by the world today is that of unemployment. While the magnitude of unemployment in the developing countries has recovered somewhat in 2008-09, the situation remains grim in the transition economies. Even the recovery in the developing countries which has been slightly better than that projected by the IMF has been below trend growth projection.

Saying that the urgency with which the US government undertook recovery measures ensured that the economy did not go into deeper recession, he argued that the recovery could have been better but for the lagged effect of the expansion plan. In this context, he pointed out that the serious problem of lack of coordination among the G7 countries failed to bring about a stronger and robust stimulus that could have benefited all major country groupings, especially the LDCs. Therefore, he suggested that the only way to ensure a sustainable recovery is to have a more coordinated recovery efforts than what it has been at present. However, there is very little evidence that even the G20 is likely to bring about greater coordination.

Further, in the West, especially in the US, he argued, there has been increasing lag in terms of job recovery compared to output recovery, which raises concern about the time required to achieve job recovery in the current period.

In this context, he emphasised that financial globalization has not contributed towards growth or reduced cost of funds. Instead, it has exacerbated volatility and instability and has resulted in significant flow of funds of financial resources from the South to the North over this period, the major recipient being the US. Therefore, there is a need for a much clearer systemic reform agenda to ensure far greater macro-financial stability, to finance growth and to ensure a more developmental and inclusive financial system.

In his opinion, the major problem impeding a reform process is the lack of willingness to undertake such comprehensive reforms. The Stiglitz Commission Report takes into account some of these issues, mainly the macro-financial issues, he pointed out. Jomo K. Sundaram concluded by enumerating four major dilemmas the international community faces which has manifested in four major crises in the recent period. One major challenge is the problem of climate change versus development. He emphasized the need for reducing climate change while raising living standards for all by expanding renewable energy provision while reducing greenhouse gas emissions. The other challenge is that of rising food prices. He suggested that all these challenges can be addressed together. The availability of cheap credit before the crisis led to over-investment in most economic sectors. But there was very little investment in food production or renewable energy because of low returns. He felt that with publicly-provided incentives and cross-subsidization at a global level it is possible to make these investments viable. This would, according to him, allow the world community to not only address the issue of climate change, development and food challenge but also help recover from the crisis. He also briefly referred to the Global Green New Deal which would involve significant cross subsidization by the rich countries particularly for the poorer countries to ensure that the developmental emphasis is not compromised while addressing the problem of climate change and food insecurity.

In the ensuing discussion, the Chair, **Abhijit Sen,** pointed out that there is contradiction in the two points made by Terry Mckinley regarding the existence of global imbalance and imminent depreciation of the dollar. Highlighting the main points of Prabhat Patnaik's argument about the inevitability of global imbalances and impossibility of reducing poverty in the current scenario, **Abhijit Sen** proposed an alternative model. He argued that global finance (which is need of a creditable bubble) can resort to lending more to achieve high growth, as it had done earlier. This time round it could lend to households in the developing countries and in order to do that they need a revenue model for ensuring that these loans are paid back. For that, expenditure on sectors like food, climate change, health & education (apart from providing the avenue for generating a bubble) could also give a measure of public revenues which gives a future flow of income and against this future flow of income lending might be made possible. Similarly, conditional cash transfers too offer future revenue against which lending can be made. Expenditures like these could act to reduce the margin between the surplus earned by firms (in the modern sectors) and minimum wages paid. In that case, even though poverty will not disappear, globalised finance-led bubble can actually be used as a poverty reducing technique on a massive scale.

Ajit Singh (Cambridge University) pointed out that given the global imbalances, the financial system was in a way trying to resolve them. It had been allocating resources to the US which could use it in a much better way than many other countries. He mentioned that these imbalances were not that big that a reasonably decent financial system cannot resolve. Secondly, had the imbalances been the cause of the problem then it would have resulted in a run on the dollar, which has not happened. He also wanted Prabhat Patnaik's opinion on the reasons impeding India/China's growth given that Italy and Japan had similar growth trajectory, and asked whether the fast growth of India and China are at the expense of the US workers or they are complementary. **M.S. Bhatt** (Jamia Milia Islamia University) wanted an elaboration on the diffusion theory and its comparison with the Lewis model because the Lewis model considers overpopulated underdeveloped countries and at the end there is homogenization of the two sectors and dualism ends. And it is the profit earners who can save and they are the engines of growth. Further he wanted to know the difference between the diffusion theory and Gunder Frank's theory where he talks about the same thing. He also queried about the role of American subsidies to the armament industry and its impact on world economic order. **Nityananda Mandal** (TERI) asked whether lack of confidence in financial assets would lead to decline in finance capital and the likely reactions of the developed world to such a possibility. **Sunanda Sen** (Professor Emeritus, Jamia Milia Islamia) pointed out that continuing current account surplus in the developing countries is generated through wrongly formulated official policies. Secondly, she mentioned that there are policy binding on these countries which in the literature are referred to as "trilemma"; they include capital account openness, exchange rate management and independent monetary policy. She stressed that China is in deeper trouble due to capital account openness and fluctuations in the stock market. **Sangeeta Ghosh** (RIS) wanted Prabhat Patnaik's opinion on the alternative to the revenue model which builds on the sectors with future potential like food, fuel etc., and the ways of financing rising level of household indebtedness so as to bring out some kind of resolution to rising impoverishment. **Shipra Nigam** (Research Scholar, JNU) wanted to know the limits to the growth of such a model and its redistributive implications. In the context of rebalancing in terms of domestic demand and moving out of export-led growth in China, **Rohit** (IIT, Delhi) pointed out that due to the growing inequality in China it would be difficult to sustain a domestic consumption-led growth. Regarding China's diversification of trade as argued by Terry Mckinley**,** he contended that if the currencies of the countries where China diversifies are pegged to the dollar, then appreciation of the *yuan* would have the same effect on those economies as well. He further asked whether China's current account surpluses would continue to grow even in face of a protracted crisis in the US. He also wanted to know whether India can be compared to the US economy, given that India, like the US, is not an export-led economy and has significant and rising trade deficit.

Debabrata (Student, JNU) queried about the reasons as to why a realization crisis would not have any effect on the diffusion-receiving countries. Noting the wide divergence in the view of the presenters about the future state of the world economy, **C.P. Chandrasekhar** (JNU) wanted their opinion about the global economy in the next 3-5 years. **Padmeswar Doley** (Delhi University) asked, given that there are high fiscal deficits in the developed countries, whether it is possible to have a model with cross subsidization for developmental activities that is self sustaining. He also pointed out that it is not necessary that developing Asian countries would always remain poor, as empirical evidence shows that the Southeast Asian countries and the East Asian Tigers had also come up from being low-income countries.

In response, **Jomo K. Sundaram** began by saying that he doesn't agree that a massive bubble is required to have global Keynesianism which becomes the basis for sustainable development through public subsidies with significant private investments (in renewable energy and food production). The reason, he said, is that there is now significantly expanded food production, unlike the green Revolution era which was limited only to wheat, maize and rice. Also, a lot of money is being pumped into the poorer countries to set them on a developmental path based on renewable energy. As a consequence there is higher output with availability of modern energy and, on that basis, far greater economic growth can be achieved. Regarding greater coordination among the countries, he contended that the G7 has never been able to achieve significant coordination among them for a long period of time. Although more countries are now participating in discussion, still it is largely a few country blocks such as the basic countries which have overwhelming influence. Responding to the question on the role of American subsidies to the armament industry, Jomo K. Sundaram replied that although the US consistently has denied it, its spending on military is the greatest single industrial policy effort in the world particularly in the area of technological advancement. The internet revolution is a fallout of the US military spending. Regarding the issue of IMF conditionalities and rising fiscal deficit, he argued that the conditionalities have not disappeared. There have been some changes in the conditionalities but that has been very much politically driven. Right now only three countries Poland, Mexico and Columbia have automatic access to fund resources. Such kind of privileged treatment is due to political reasons. However whether the IMF has changed in a fundamental way so as to better serve the developing countries is disputable, he argued. He said that the poorest countries are eligible for certain types of IMF facilities that are discounted, but at a very high price because they come with policy conditionality. On macroeconomic policy coordination, he underscored that there is no meaningful macroeconomic policy coordination now. However, he also mentioned that the nature of the protectionist measures undertaken so far has not been terribly onerous. One of the major elements of macroeconomic policy coordination has been that the fund has allowed much more breathing space than what has been allowed so far.

Terry Mckinley responded saying that the backdrop to the interlocking of the US and China together in an interdependent situation, is that of an ageing imperial power that is declining. It is an unstable situation in which the US is trying to place much of the adjustment on China. But China has no interest in rebalancing its economy because its export-led strategy has been successful in achieving very high rates of growth although the working class and the peasants have paid a heavy price in terms of depressed income and wage level. On the part of the US, he felt that the US would manage the situation in the foreseeable future. Since there is no other alternative to the US dollar, most developing economies and emerging economies have to pay the price. Regarding the issue of global finance's need for another bubble, he replied that that they are already on the way to create another bubble by attempting to increase lending to the emerging economies. China has already lent to the rich developing countries for real estate and equities. In his opinion, therefore, there is going to be a major bubble. According to him, the financial system is reallocating resources to the US, especially countries which are following an export-led model. Terry McKinley argued that the high growth of India and China is not good for the US. The trade account suggests that China has surplus with the US. It is the developing countries of Asia that are actually benefiting from their growth and not the US. According to him, China is not facing any 'trilemma' as China has been able to run a successful export-led model with a tight control over domestic financial system and also have some degree of control over the capital account. However, he feels India or other developing countries might face such a situation. Regarding the financial debt, he argued that if China appreciates the exchange rate, other developing economies that were exporting to China would benefit, but since China would be going slow, the quality effect would be weakened. Therefore the situation is unstable and unclear.

In response to the questions raised, **Prabhat Patnaik** said that the main issue is that of explaining the maintenance of wage differentials even in a world of free diffusion of activities. Traditionally, he argued, wage differentials occurred because the advanced countries imposed a monopoly via colonialism and as a result there was little diffusion of activities in the colonial pattern of international division of labour. Further, earlier there was also the belief among those in the left that neo-liberal policy would hamper diffusion of activities and hence trap countries like India into being low-wage, underdeveloped economies. Another way, in which wage differential can occur is through innovation of the Schumpeterian kind in one part of the world that lead the workers in that part of the world to bid away a part of the profit and thereby maintain a higher wage rate. In such a scenario, continuous innovation will culminate into perpetual high wage rate.

But since in the current period there is apparent break down of the colonial international division of labour, he pointed out that, the persistence of wage differentials between the North and the South becomes problematical. In this context he contended that there need not be any unemployment in the North because of competition from the South for the reason that Keynesian demand management can be used for avoiding deindustrialisation in the core. But as long as the wage differential continues, the global imbalances would necessarily continue. Agreeing with Jomo K. Sundaram, that it is possible to have a recovery with emphasis on investment in the new sectors like food and energy, he argued that for investment to be least destructive of peasant agriculture, support from the state would be required. But this alone might not be enough to absorb the labour reserve and there has to be some kind of restraint on the rate of structural and technological change, as had been done in former Soviet Union and which Kalecki termed as 'extensive extended reproduction'. Regarding alternative to capitalism, **Prabhat Patnaik** opined that there is no solution within capitalism for the problems of poverty. As Rosa Luxembourg had argued capitalism destroys petty property, peasant production. Therefore, he said, it is only by going beyond capitalism it is possible to preserve petty production and peasant-agriculture led production which would be essential for using up labour reserves. It is this problem of labour reserves that would also impede countries like India and China from being able to follow the path of Italy or Japan as at that time these countries were not competing against Third World labour reserves.

Further, he argued that any decline in finance capital is not spontaneous and that would have to be politically achieved. On the question of limits to growth in the revenue model, he said that the peasant agriculture-led growth would not necessarily take the form of finance capital sustained bubble. On the comparison of India with the US, he pointed out that former cannot be compared to the latter for the simple reason that the former is a huge labour surplus economy. Finally, he concluded saying that the crisis is not likely to get over in another three or four years because the net stimulus is not very significant. As a result, even if financial sector comes out the recession, according to him, the output and employment would remain stuck at a very low level for quite some time. As far as India is concerned, he contended that there would be little reduction in poverty.

In a second round of discussion, **Amarjyoti Mahanta** (Research Scholar, JNU) raised the point whether there would be convergence of wages in a system where there is flow of capital from the 'core' to the 'periphery'. To this **Prabhat Patnaik** clarified that he did not talk about flow of capital but diffusion of activities that can be taken up by local capital. He also highlighted that in a world without barriers to free flow of activities, wage differentials cannot be sustained because there is no monopoly element in that case and innovativeness won't be significant.

Ajit Singh pointed out that in so far as the policymakers have tamed the crisis and the financial system has been stabilized, it is a triumph of Keynesianism. However, it is not a happy situation as it is something akin to a neoclassical synthesis of Keynesianism (what Joan Robinson termed as 'bastard Keynesianism'). This is because now the more important agenda seems to be the withdrawal of the welfare state to pay for the stimuli. He queried about the implications and the ways to deal with the increasing withdrawal of stimuli in various countries. Responding to him **Prabhat Patnaik** said that there is ambiguity in the attitude of many of the progressive economists towards Keynesianism. He prefers to call them contingent Keynesians as they typically advocate fiscal stimulus package at the time of the crisis but withdrawal of it as the intensity of the crisis comes down. **Terry McKinley** agreed with Prabhat Patnaik on this issue saying that it is crisis Keynesianism and that it is a very difficult ideological situation where some ideas have been co-opted but have not really been applied.

With reference to issue of most of the US companies relocating to China, China's emergence as a leader in terms of green technology and its setting up of military bases in different countries, **Kasturi Das** (RIS) queried about the emergence of China as a global power in the medium to longer term. To this, **Terry McKinley** argued that unlike Japan and Germany which had also generated equally huge current account surpluses earlier, China's emergence has been a subject of much criticism. The reason was that Japan and Italy were militarily and politically subordinate and could fit themselves in a slot within the global capitalist economy, politically as well as economically. But China's emergence is upsetting the global balances - economically, politically and militarily.

Agreeing with Ajit Singh's comment on 'bastard Keynesianism', **Jomo K. Sundaram** said that this was also the essence of Paul Samuelson's view, which advocated neo-classical measures in normal situations and Keynesian measures during crisis situations. Responding to an earlier query, he said that it is true that the productivity measures suggest very high productivity growth in the US, but a large part of this productivity growth is because the US has been de-industrialising and many of its industries have relocated. As a result, the remaining industries had to register tremendous productivity growth simply for being able to survive. And that is why corporate interests no longer coincide with the 'national' interest. Speaking about the role of the UN in policy formulations, he mentioned that time and again the UN's recommendations that have been participative and progressive have either been undermined or when adopted, hijacked by other international agencies like the World Bank. On the UN's position on increasing food security he said that although the aim is to promote smallholder food agriculture, the problem with the UN formulation is that it does not address important issues like that of land distribution. And it is important, he said, to address the old concerns of agrarian reform and land reform, rather than abandon them.

Referring to the issue of the global green new deal, he said that the idea has little attraction for countries as the main focus right now has been on national level recovery, which undermines the possibility of multilateral cooperation. In this context, he said that the G-20's increasing undermining of developing countries' solidarity is a matter of great concern. While earlier India and Brazil have provided very important leadership on many issues concerning the developing countries, now it is only India which offers resistance to undesirable WTO issues. But lately the Indian government too has been compromising on various issues. And if the defence put up by India also comes down, then it would have adverse implications for other developing countries, not only on WTO issues, but also on issues concerning climate change and host of other issues that are likely to crop up in the foreseeable future. He concluded by saying that it is only when countries like India, China or Brazil identify themselves with issues such as the global green new deal that some progress can be made.

Day 2, 30 January 2010

Session I–Finance and the Real Economy

The session was chaired by **C.P. Chandrasekhar** (JNU, New Delhi). The first speaker, **Rizal Ramli** (Komite Bangkit Indonesia), said the degree of decoupling of the financial sector and the real economy was crucial for understanding the impact of finance on the real economy. He noted significant differences in the Anglo-Saxon model (neoliberal model) and the North East Asian model. In the former model (e.g. Indonesia), which relied on liberalization of all sectors including finance, there was a significant degree of the decoupling of finance from the real sector. Because of the dominance of finance, the economy was rendered vulnerable to the fragility of international finance, artificial exchange rates etc. In the latter model such as those of Japan during 1951-73 and 1976-84, Taiwan and Korea, there was gradual liberalization of the real sector and partial liberalization of the financial sector. In most cases, the real sector dominated finance, and there were adequate capital controls and exchange rate management to promote industrialization and export.

Going into the specific case of Indonesia, he said that in 2008 there was a large inflow of debt and speculative hot money, but the economy grew only moderately. During the world financial crisis of 2008, almost all financial indicators underwent significant correction. In 2009, the economy declined only slightly growing at 4.1%, helped by the fact that Indonesia's ratio of export to GDP was only 30%. The effect of the financial crisis on the economy was thus relatively small..

Speaking about the high growth of the economies of North East Asia as contrast to the Indonesian experience, he pointed out that the subordination of finance to the real sector was one of the reasons for this. China, for example, saw double digit growth rates over the past two decades. Strategic undervaluation of its exchange rate boosted export and provided implicit protection for the domestic industry. Capital controls provided macroeconomic stability and a low interest rate regime ensured a low cost of production.

Elaborating on the different relationships between finance and the real sector on macroeconomic performance and the capacity to create jobs, **Rizal Ramli** argued that in the neoliberal model there is heavy reliance on the inflow of debt and hot money, often leading to a BoP surplus and an artificially strong local currency. This externally-driven growth is characterized by de-industrialization and a jobless growth pattern. For example, the Indonesian industrial growth which was more than 12 per cent during the 1980s fell to less than 1.4 per cent in 2008-09. On the other hand, the North East Asian economies relied on undervalued exchange rate, slow pace of financial liberalisation and increase in productivity and competitiveness in the real sector. The result was accelerated industrialisation, huge foreign surplus and significant job creation.

The ill-effect of reliance on speculative capital was evident during the recent financial meltdown. Indonesia was the only country in the world then to increase interest rates in order to prevent the flight of hot money. As a result, the economy underwent a heavy contraction. The comparative dollar bond yield was the highest in Indonesia at 4.32%. Even the local currency bond yield was very high at 10.1%, and about half was bought by foreign nationals. This, he asserted, was a very expensive strategy, resulting in the creation of another bubble.

Further, he pointed out, that the neoliberal model was responsible for the return of the colonial economy with Indonesia increasingly becoming exporter of raw materials and importer of manufactures. The free trade agreement with China has not helped matters either. As far as the balance of trade of Indonesia and China over 2004-09 is concerned, the former has been exporting primarily resources and importing manufactured goods and textiles. The same is true for India and Indonesia. He concluded by saying that such a trade strategy is unsustainable and therefore has to be modified.

The second speaker, **Saul Keifman** (University of Buenos Aires), contended that the crisis as an opportunity to redefine the relationship between the real economy and finance. Conceding that the consensus on the destabilizing nature of the financial self-regulation paradigm was a significant move forward, he opined that the task of stabilizing financial markets would take much more than merely introducing new financial regulations.

In this context he pointed out that the Turner Review (2009), released by UK's Financial Services Authority (FSA), though a remarkable document, providing a critical insider's view of what went wrong with global finance, offers very little in terms of regulation. The report, after recognizing the importance of market failures, irrational behavior, financial liberalization and securitization in determining asset price bubbles, only recommends finding ways to prevent or mitigate excessive credit supply as a method of regulation. This, in Saul Keifman's opinion, was a contradiction and the emphasis on excessive credit supply reveals a misinterpretation of bubbles as asset price inflation. In short, the report doesn't seem such a radical departure from conventional wisdom. In contrast, the Stiglitz Commission Report (Commission of Experts, 2009) takes a broader view of the genesis of the crisis and does not limit crisis prevention only to new financial regulations. Instead, it points out the key role played by deregulation not only in the financial sector but in the overall economy. In this context, Saul Keifman asserted that the increased frequency of financial crises and macro instability noticed in the last three decades is the consequence of the neoliberal programme which resulted in the currently hegemonic variety of capitalism known as finance-led capitalism or *financialization.*

Regarding financial regulation in the developing countries, he argued that the required measures of reform are different from the ones highlighted in the Northern agenda. The main challenge for developing countries, according to him, is to design financial and non-financial institutions and regulations which prevent capital flight, reduce drastically capital flows volatility, and mobilize and allocate domestic savings to productive investment.

Saying that developing countries have long ago given up the illusion of tapping substantive financial flows in international markets to finance development, he argued that even the attempts to protect themselves against "sudden shocks" by accumulating huge international reserves and to avoid IMF conditionality has a sizable welfare cost and collectively imposes a global deflationary pressure. Capital controls could help reduce the amount of international reserves needed for self-protection, and also allow more policy space to pursue monetary and exchange rate policies more conducive to developmental goals, moving away from the corners of Mundell's triangle. Therefore, the WTO-GATS commitments, bilateral preferential trade agreements clauses on financial services, and bilateral investment guarantees might have to be reviewed, he asserted.

He also emphasised the need for South-South swaps and other monetary clearing arrangements to save international reserves, and truly regional banks and/or monetary funds to help out during country-specific crises. He felt that prevention of capital flight was possible only if tax and regulatory havens were closed down, bank secrecy ended and global taxation implemented.

Limiting crisis prevention, he argued, must not be confined to new financial regulations because bubbles were not only fed by deregulation of finance but also by the deregulation of the overall economy. During the Golden Age, high levels of government expenditures, progressive taxation and social protection systems acted as powerful buffers and automatic stabilizers. But in the last few decades these were weakened or removed in many countries and the increased frequency of financial crises, macroeconomic instability and higher inequality in the last three decades was due to the triumph of the neoliberal programme, resulting in finance-led capitalism or *financialization.* Financialization, he felt, is the result of a political construction that took three decades to dismantle the institutions of "embedded liberalism" and replace it with a new institutional architecture. There is therefore a need to seize the moment to pursue serious reform and foster the unravelling of financialization.

Therefore, he argued, the overhauling of many other institutions, apart from the financial ones is required for re-establishing the balance between the market and the state, and to turn finance into the servant of the real economy and social progress. For, institutions conducive to social justice not only serve well this goal but are also a means to achieve macroeconomic stability and sustained growth.

The third speaker of the session, **Gabriel Palma** (University of Cambridge, UK) asserted that an understanding of what is happening today is possible only by having some idea of what neoliberalism is about. He referred to Foucault's classical view of neoliberalism as a 'new technology of power', where there is a new interaction between political power and the dynamics of the unregulated markets. This differs from the Marxian perspective that looks at neoliberalism as a counter-offensive of capital. He dug deeper into the issue by pointing out that the declining trend of the income share of the top 1% of the population from the 1930s to the 1970s reversed with the election of Reagan and Thatcher. How this could take place in a democracy, he said, was the key issue to be kept in mind while trying to understand neoliberalism.

Seen from a Marxian perspective, he argued, neoliberalism is basically a new form of dispossession; also, on the supply side, it is about how to achieve more extreme forms of rent-seeking accumulation. From a Darwinian perspective, neoliberalism is about the creation of an economic environment suitable for the characteristics of capitalism. Thus the liberalization of the labour market, independence of central banks, opening up of capital accounts etc. are some of the ways of creating an environment in which capitalism can thrive.

He asserted that the recognition of the peculiar political coalition within capital - between financial capital and industrialists of the previous technological revolution - is important for understanding neoliberalism. Apart from making the bottom 90% put up with increasing inequality, neoliberalism had been able to generate the spontaneous consensus around it. For example, in the United Kingdom, the FSA, which builds new regulatory system for the financial markets, is not even a state-based authority but financed by the market and staffed by the people of the market. Besides, he argued, the role of the New Left in the generation of the spontaneous consensus that there is no alternative to neoliberalism, could not be underestimated.

On the financial crisis, he stated that although there is some recovery seen, one of the key characteristics coming out of the crisis has been the focus on how a new bubble could be created. The emphasis is on how more optimism and dynamism can be brought in to move the wheel again. In order to bring back some movement, there is a need for some magnetism which is possible only with a new bubble. He said the first law of macroeconomics is that once the world encounters a macroeconomic problem, there is no solution; what can be done is to simply shift the problem around. At the moment, the focus is on how to shift the problem of the financial market and bring it into the public sector in terms of the massive increase in public debts and show some flexibility in the private sector. The pessimism with regard to the recovery arises from the fact that a private problem has been brought into a public sector with the huge accumulation of public debt, and that has happened without solving the problem in the private sector.

Asserting that the issue of income distribution is at the root of the massive increase in financial liquidity in the US and Europe, he showed that the share of the top 1% in national income moved in congruence with the share of financial assets as a percentage of GDP. Saying that the stability in the share of financial markets in national income, an important aspect of the Keynesian period, has been upset under neoliberalism, he pointed out that the massive increase in the share of financial assets as a percentage of GDP under neoliberalism has absolutely no effect on the share of investment in GDP.

He concluded on the note that the crucial characteristics of the neoliberal period in the US, UK, Europe etc., was that a massive increase in the share of the national income appropriated by the top 10% was not accompanied by an increase in private investment as a percentage of GDP. Under neoliberalism the middle income countries are showing the more advanced countries the image of their own future. This, he said, was crucial to understand not only what brought us to the current crisis but how difficult it is to come out of it. In a system led by rent-seeking behaviour and by not-so-progressive capitalist elite, capitalism has lost its historical legitimacy, he said.

In the discussion that followed **K. Sai Baba** (Delhi University) wanted Rizal Ramli to clarify whether it was North or South Korea being referred to and also queried about the post-tsunami inflationary trend and its effect on the Indonesian economy. He further queried about the possibility of regulating the black economy and whether new technological economy is an egalitarian approach for developing nations. **Balakrishnan** commented that Singapore's contraction was due to its integration with the rest of the world via trade, thereby reflecting that a country could be vulnerable when it is integrated with the world, independently of finance. He further pointed out that there could be financial conservatism, completely independent of neoliberalism, like in the case of India, which had a high interest rate regime in the last fifty years.

Ajit Singh (Emeritus Professor of Economics, University of Cambridge) enquired about the reasons for increasing inequality in income distribution and the explanation behind the inequality within the same professional group. He argued that the only way to reverse such a tendency would be to think about a cultural revolution. **Sudipto Mundle** (NIPFP), enquired whether there were any systematic forces driving the reduction in the share of the top 1% as shown by Gabriel Palma.

Citing arguments that large income inequality is accompanied by faster economic growth, **Arijit Das** (Research Scholar, JNU), asked if there is any relation between the two. **Surajit Mazumdar** (ISID) asked Gabriel Palma whether the income distribution of the bottom 90 per cent showed a common trend or there were divergent trends within them, as this would be relevant in answering the question of how such inequality could sustain in a democratic framework.

Jayati Ghosh commented that perhaps there was a need to look at the different nuances within a broadly neoliberal model, given that both Indonesia and Malaysia followed neoliberal policies but impact had varied. Agreeing with Saul Keifman's point about developing countries' holding of dollar reserves being deflationary in impact, she said an important aspect here is the role of exchange rate management which again reflects export obsession and the need to keep the exchange rate competitive. Commenting on Gabriel Palma's point about the dramatic shifts in global income distribution, she said they seem to occur through different periods of relative price changes and therefore it required examining whether something else was going on in there. She also said there was need to look beyond just the top 1% and the bottom 90%. The success of the reforms, according to her, was the complete integration of the middle classes into the aspirations that were created by market-oriented neoliberal framework. In that context, she enquired whether the stability of the income shares of deciles 5 to 9 was part of the answer to why this happened, giving the political consensus to allow such things to happen. She also wanted to know whether the finding on Latin America that every crisis results in the increase of the income shares of the top 1 decile relative to the next 9 deciles could be applied in the more recent experience in the US. **Satyaki Roy** (ISID) reiterated Gabriel Palma's argument about capitalism being able to get away with a high level of inequality within democracy because of technology of power. He said that Gramscian hegemony was compatible with Gabriel Palma's presentation, but Foucauldian technology of power, which flows from Foucault's notion of governmentality, was insensitive to a kind of transformative policies and to the fluctuations that occur in the economy. He wanted to know how it was possible to club one argument that neoliberalism is a counter-offensive of the ruling elite with a static notion of governmentality as there was no entry point, where a change in the political economy might have been suggested. **Soumyajit Bhattacharya** (Delhi University) argued that apart from strong political reasons, there must be something in the accumulation structure, in which mass consumption had an important role to play, that made possible the increase in income of the bottom half by four times in the post-war period. Therefore, he asserted, the shift in the distribution in the later period must be located in the accumulation structure.

Shipra Nigam (Research Scholar, JNU) argued that Foucauldian framework was not appropriate for kind of analysis where one is talking about the rise of inequality in a democratic framework, on the one hand, and the collusion between finance and old industries on the other. She contended that there were enough tools and apparatuses within the Marxian framework which could be used to understand these phenomena. **Amarjyoti** (Research Scholar, JNU) questioned **Gabriel Palma's** assertion of the existence of Nash equilibrium given that the share of the bottom 90% remained the same but that of the top 10% kept increasing. He also pointed out that if private investment is taken as a proxy for some kind of progressiveness, there is a need to differentiate between different types of private investments.

In response, **Rizal Ramli** said that it was not correct to say that Singapore is very neoliberal as the role of the government is very strong both in the economic and the social sphere. The fact that its Central Bank is under the ministry of finance ensures that monetary and credit policies are in line with the government's economic and social objectives. Thus, even while its economy was liberalized, government presence was still high. He agreed with the assertion that it is possible to have financial conservatism independently of neoliberalism. Some degree of capital control and absence of full convertibility insulated India from external shocks. The reverse was true of Indonesia.

With regard to the question of whether there can be growth with equality, he said during the 1980s the debate, in fact, centred on it. He said the key to it is to look at inflation more differentially. He gave the example of Indonesia where inflation for the lower middle class was double the inflation for upper middle class. In this context he argued that stabilising prices of food and basic commodities, can stem erosion of the purchasing power of the lower middle class. He also argued, that with a Keynesian policy the chance of controlling or minimising inequality was much higher.

He also pointed out that there was a huge margin between the interest rate that a developing country has to pay and the US Treasury rate. It is unfair, he lamented, that a country that needs capital has to pay a much higher rate than a country that has an abundance of capital. A country that relies heavily on inflow of hot money has to pay a much higher premium, giving that country an artificially strong local currency. FDI, on the other hand, leads to creation of jobs. While in the 1970s to late 1980s, ASEAN was the main venue of FDI, since the late 1980s, India and China have been attracting more investment.

Responding to Jayati Ghosh's question, he agreed that the Malaysian and the Indonesian models were different. During the financial crisis in 1998, Indonesia invited the IMF, and in doing so the economy declined by -13% due to a lot of policy errors. Malaysia, on the other hand, resisted IMF intervention and put temporary capital controls and came out of the crisis almost without a scratch. On the question of industrial policy, he said that during the Suharto era, there were at least some policies to promote economic growth. But after the crisis, finance was allowed to dominate the real economy in Indonesia. He then asserted that usually a crisis was used as opportunity to push liberalisation to the maximum and with finance dominating the real economy and little industrial policy, has accelerated de-industrialisation in Indonesia.

Regarding the effect of foreign banks because of Indonesia opening up its banking sector, he said there was a marked shift towards consumer lending. The expectation that increased competition with the entry of foreign players would result in lower net interest margin did not happen. Indonesia's net interest margin of around 5-7% was one of the highest in the world. Thus, the banking sector in Indonesia was very profitable despite not having to lending too much.

Agreeing that the underground economy should be taken into account when talking about regulation, **Saul Keifman** said that a distinction should be made between two types of underground economy: the poor, who have no option but to evade regulation; and the rich. For example, in Argentina in the 1970s, before neoliberal policies had been introduced, 75% of workers were registered. They enjoyed such benefits as social protection. However, in the 1990s, this came down to 50% or less while in the last 8 years, the number of registered workers has increased again.

In response to Ajit Singh's question, he said capital is free to move under the neoliberal regime but labour is not because of an ideological and political construction suited to the needs of finance capital. With regard to Jayati Ghosh's comment about serious arguments in favour of holding high international reserves to protect against financial crisis, volatility etc., he said that there is also a certain obsession with competitiveness, which is reflected in the need for huge current account surpluses. He felt that there was no need for obsession with competitiveness and hence with huge current account surpluses. This is because it has high social opportunity cost, especially for the poor.

To the question of IMF eulogising securitisation, he said banks were able to limit or overcome the problem of asymmetric information since they knew who the debtors were. Securitisation resulted in the selling of security to the less informed. Credit rating agencies, who took the place of banks, were paid by the same people underwriting the securities. So this was really a scheme to fool small investors.

Responding to the question regarding reasons for increasing inequality, **Gabriel Palma** said that statistically it was impossible to explain the kind of income distribution in existence. In the US, in the late 1970, the income of the bottom 90% remained stagnant with the top 10% appropriating the national income. During the Bush period, 73% of additional income went to the top 1%. The average income growth in the US corresponded to the income growth of percentiles 90 to 93.

On the issue of growth with equality, he pointed out that growth of average income and personal consumption of the bottom 90% in the US remained the same from 1950 to 1980, while during 1980-2005 the rate of growth of personal consumption continued at the same rate, but the growth rate of average income fell. With the advent of neoliberalism, the system of part-pay and part-lend of wages was introduced, in order to realise the goal of capitalist accumulation. And the end result was financial fragility, which is at the bottom of the current crisis.

On the issue of Nash equilibrium, he said there was a need to distinguish between two stages. At the first stage i.e. before the 1980s, a game with three outcomes: a pure solution on the one side, another pure solution on the other side, and some kind of stable solution at the middle, was being played out. The rate of growth of income of the bottom 90% was about 4 times faster than that of the top 1% during this period and that was because of the Keynesian consensus. Post-1980s, with the election of Reagan and Thatcher, there was a complete reversal of this trend. However, instead of moving from one extreme solution to another, neoliberalism's sophistication of technology of power enabled it to convince the bottom 90% that there is no alternative. The game shifted to something that was much more stable and sustainable. What it became was a situation in which the bottom 90% would not only take it as a necessity but would be convinced that there was no alternative. That's why it has continued to be so stable; even at the current moment of crisis, politically there is very little happening in the advanced countries. In fact if any, he argued, there is any movement in the opposite direction.

On the issue of global income distribution, he said, middle half of the world population (deciles 5 to 9) showed a remarkable homogeneity in their share of national income, which was roughly 50%. All inequality was due to what is happening in the top 10% and in the bottom 40%. So, there is some kind of centripetal force in the middle 50% which made them end up having exactly the same share of national income. On the issue of homogeneity in the middle, he said this situation came about in the 1970s, 1980s and 1990s. In the US, the top 1% appropriated 75% of the income growth during the Bush presidency; the bottom 90% had stagnating real income growth for 30 years. The answer to the question why this is not challenged even in a democracy, lie in the crucial characteristic of neoliberalism, which is the sophistication of the technology of power.

He pointed out that Foucault was trying to describe the neoliberal system, investigating how the economic and the political worlds were interlinked. Even while there was a lot of commonality between Foucault's and Marxian analysis, the latter analysis was more comprehensive and sought to look at how the neoliberal model operated in the real world.

On the question of private investment, he said an important issue about the current political settlement in the developed world is how globalization has brought about middle income countries type of political settlement and distributional outcomes to the advanced countries. Using the Marxian perspective, he said it is not that the advanced countries are showing the less advanced countries the image of their own future but rather it was the other way round.

Session 2: The future of finance

Speaking on the theme of the session, **Leonardo Burlamaqui** (Ford Foundation) argued that the prevailing mainstream economic theory failed both in terms of understanding what was going on and predicting what would happen. At its core was the belief that the market was capable of solving the problem without any intervention, and hence regulations were perceived to be a part of the problem rather than the solution.

In Leonardo Burlamaqui's view, the financial system has regressed from a mostly Schumpeterian configuration to a Sorosian kind of system. The financial sector was meant to finance development by providing long-term funding for technological innovations and productive investments. Instead it had changed to a system where the criterion for providing financial support was not productive ventures but higher profits. It eventually led to the development of financial instruments and innovations. This basically led to a casino kind of capitalism where it was not the unique knowledge of the firm's strengths that mattered but a knowledge and ability to get out of the legal loopholes of corporate regulations. Thus, the financial innovations were now financing speculative activities and not productive activities. The financial sector eventually resorted to Ponzi Schemes and in the process leading to the current downfall. He therefore called for a revival of the Schumpeterian system once again.

At the same time, Leonardo Burlamaqui pointed out that the current global financial system is much broader than the banking system alone. It is mostly unregulated, interconnected and continuously changing structurally. Hence, reforming the financial system is going to be an extremely complex task. Geopolitically, the emergence of the G20 is a major development for the capitalist system. Many of the large and otherwise opaque organisations such as the Basel committee and Financial Stability Board (FSB) also expanded their membership to include the BRIC countries and others. While this may seem as a process of democratisation, in essence the UK and USA have the power to override all others in these bodies.

In the current context, the Asian and Latin American countries seem to be better equipped to deal with the crisis, but this might not last long. The Chinese stimulus package, which was double in size to the US package, will certainly help Chinese growth and the only question about it is its impact on other Asian countries. The American Recovery and Reinvestment Act has succeeded in avoiding depression, but whether it can trigger a recovery is still questionable. Moreover, the US and Europe has been experiencing the return of the State and the system of public ownership of financial assets and institutions. All these might be a sign of a new form of capitalism arising in the post-crisis situation.

In the US, the root cause of the crisis, the toxic assets are still with the banking system and real economic conditions continue to worsen. Unemployment rates are still growing. The number of delinquencies is still high and growing not only in the sub-prime but also in the prime section of the mortgage markets. Foreclosures have been rising even through 2009. Financial concentration has increased even though the ‘too big to fail’ argument has been proved wrong. Investment banks are back in business again realizing super profits but the credit is still not flowing freely. On the other hand, none of the ‘jumbo’ banks are realizing any gains.

For a recovery, the U.S sub-prime crisis should be resolved by helping the homeowners and increasing the aggregate demand rather than pumping money into the banks. Steps should be taken to rationalise the regulatory maze. A Financial Products Safety Agency should be established.

In the paradigm of political economy, the world seemed to be facing a big trade-off between corporate-sponsored globalisation and democracy. The reform agenda’s vision should be one which rejects the idea that the markets can regulate themselves and one that puts an end to the supremacy of private interests over public interests.

Ajit Singh (Emeritus Professor, University of Cambridge), began by pointing out that there are two broad models of the financial system across ideologies. The first is the Lucas-Joan Robinson School which believes that the financial system is a product of economic development and is determined by the same. The second is a more orthodox view, shared by the likes of Hicks, which holds that financial system is a necessary precursor to economic growth and development. For example, Hicks believed that the industrial Revolution in England was delayed by around five decades simply because the financial system was not mature enough to facilitate investment financing even though the technology was already present.

However, it can be seen that the financial system had very little independent role in the development stories of either Japan or Korea. Despite being open economies, both had strict financial regulations with nationalized banking and stringent capital controls norms. This system managed to achieve high growth rates and it was accepted as a norm that the State must have the command of the economy which included the banks and the insurance companies.

The late 1970s and the 1980s witnessed a paradigmatic shift. The Thatcher era in England wrought a change and eventually financial globalisation with its current features took over. It was expected that after the Asian Crisis, free flow of capital would be curbed. However, nothing was done in this regard. Instead, countries started building up current account surpluses to defend themselves in times of downturn.

Therefore, while talking about reforming the global financial system, things have to be viewed from the right perspective. There has been an unprecedented growth of the global economy at an overall rate of 5-6% over the last decade which is indeed an achievement of the financial system. The developing world grew faster than the developed world, and for the first time the number of people below the absolute poverty line fell below one billion. However, this growth was limited, with the USA, India and China being the major players. The global financial system did create global imbalances. In particular, the UK and the US despite living beyond their means and having huge current account deficits grew faster than Japan or Germany which had current account surpluses. Any financial sector reform should satisfy the minimum criterion of doing at least as well as the old system i.e. the world economy should grow at least 5-6% per annum. This kind of reform is especially essential from the point of view of the third world. For that, the banking sector needs to be nationalized everywhere. The banking system should be equipped to perform the essential function of collecting savings and directing them to worthy investment opportunities. The example of Germany, where its system of hierarchy of banks has proven to be successful, is important in this regard.

Ajit Singh further argued that contrary to popular perception, the stock market is not a necessary institution for choosing better business opportunities or getting investment financing. There are no needs for instruments like hedge funds, mutual funds etc. A nationalized banking system alone without the rest of the paraphernalia is enough for the savings and investment functions of the economy to be performed efficiently. The rest of the institutions have no social value.

For poor developing countries like those in Africa, a strong nationalized bank was most important and they should completely do away with stock markets at least for a few decades. Even the IMF Vice president Justin Lin has accepted such a view in recent times.

Jan Kregel (University of Missouri), in his presentation focused on the state of recovery in the US, and said that the GDP figure for the fourth quarter which was over 5% had created some euphoria. However, the composition break-up shows that household consumption was only 1.2-1.3% which was lower than previous quarters. The ‘growth’ figure actually denotes that firms were doing restocking of inventories in anticipation of rise in demand. This also shows that bankers were still in the process of repairing balance sheets.

In this context he pointed towards two observable developments. The 1999 Act had freed the previously regulated banks and allowed them to become multi-functional banks. However, there were a series of investment banks which were neither covered by the earlier 1993 Act nor the new 1999 Act. The most famous of these were Bear Sterns and Lehman brothers who have now disappeared. The others like J.P. Morgan Chase have changed to commercial deposit banking along with insurance while Merrill Lynch has merged with Bank of America to combine commercial banking with investment banking. Thus bank concentrations are still high as bank sizes are increasing.

Secondly, the Fed has kept the fed funds rate at 0-0.25% as part of their monetary policy to counter the crisis. Thus the banks can now borrow from the Fed practically for free. Certain borrowers including those who fall in the non-prime category and who normally borrow at a spread above the fed funds rate can do so at extremely cheap rates, and a great deal of refinancing of loan positions has been going on. With signs of recovery, there is a lot of borrowing going on in anticipation of an upward movement of rates. And the low fed funds rate means that the Fed is financing their speculation at zero cost, including the amount of leverage that they can take. Brazil has been experiencing an increase in short-term capital inflows since the beginning of last year. This means that American banks are simply taking advantage of the high interest rates in Brazil to make profits.

The toxic assets still remain in the balance sheets of the banks and the Fed, and there has been little change on that account in the post-crisis period. At the same time, the US unemployment rate continues to rise. This has a direct impact on the delinquency rates on various loans such as credit card loans, home loans and otherwise prime loans forwarded earlier and so on. The new issuances can go on for only as long as much of corporate America wants to borrow and this will come to an end sooner or later.

In the meantime, those who have been relying primarily on bank financing have been losing out. As the large spreads start to come in, corporates will soon realise that there is an alternative to short-term funding from investment banks. In fact, there is already an increase seen in the number of direct bids for securities being received by the Fed.

Therefore, Jan Kregel argued, the first priority is to set up a multi-regulatory agency to regulate the various products being sold to the clients. There should be controls put on bank size as well as the bank products allowed to be sold. Stock market trading has been considered a useful mechanism of capital allocation. However, activities such as flash trading represent a sharp fall in the allocative efficiency. Such practices should also be looked into.

However, the implementation of such regulations will face challenges from numerous quarters. For example, under the terms of agreement of GATS, there is a standstill on imposition of any financial regulations. Secondly, there is a ban on policies that limit the size of financial institutions. Any economy that proposed any such a policy would be taken to arbitration under WTO. Thirdly, under the WTO, foreign firms must be allowed to introduce any financial product no matter how risky and the domestic host country has no say in it. While there are provisions for prudential regulations under the WTO in the Understanding that was signed by the member countries, it has the ‘self cancellation’ sentence which effectively negates the provisions in the Understanding itself. Thus, effectively, the WTO has written into it the deregulatory ideal. And hence the G20 cannot ask the countries to take prudential norms and regulations. Even as we talk of the financial regulations, current negotiations of the WTO and Doha round is still pushing for additional measures to deregulate financial sectors for member countries and newer signatories.

In the discussion that followed, **Shouvik Chakraborty** (Research Scholar, JNU) raised the issue of jobless growth, which has been observed in the recent global growth structure under financial liberalization. He queried from Ajit Singh as to whether he would prefer a scenario of high growth rate and high unemployment or low growth rate and low unemployment and why.

Sunanda Sen (Professor Emeritus, Jamia Milia Islamia) enquired about the social aspects of banking and what the banks can do to distribute more credit. She also wanted to know about the impact of the Basel norms which had effectively reduced the credit availability for the poor.

Prabhat Patnaik commented that the idea of nationalising the entire banking system and using the banks alone as the financial intermediary channel, in effect, amounts to avoiding a market in private property and asked whether this can be accommodated in a conventional bank-led financial system as proposed.

C.P Chandrasekhar raised the point whether Ajit Singh was suggesting that there should only be public banking carrying out a set of functions called the simple banking functions. Savers, according to him, like to have options and could want higher positive returns, without necessarily indulging in speculations. While the State could guarantee health and education and other insurances etc, the suggested solution could deprive the savers of the choice of investing in different assets.

Devidas Tuljapurkar (General Secretary, All India Bank of Maharashtra Employees Federation) observed that the genesis of the global financial crisis has been attributed to the failure of regulations and Basel committee norms. In the Indian experience, however, the ownership of the major banks has continued to remain with the State even though with deregulated interest rate structure. He queried about the future course of action that can be taken in this scenario.

In his response, **Ajit Singh** said that we could end up having too many markets which can prove to be useless. Fifty years of research has been done on this matter and the conclusions have been the same across the spectrum. The main reason for this opinion is that in the share market the decision to invest and a selection of the companies to invest in is made based on the size and performance of the company and of these, size is more important. This can be a misleading criterion, eventually resulting in stock markets evolving into gambling casinos as it happens in many cases.

He further contended that banks were capable of performing all the functions that a stock market does, especially the essential task of efficiently allocating savings. He felt that moving from a German kind of hierarchical system to an Anglo-Saxon one would be a retrogressive step with no social benefit or increase in efficiency. Sukhomay Chakravarty had once said that India did not make full use of its banking structure as per its potential. Despite its shortcomings, nationalized banking does ensure that lending is more universal which helping economic growth to be more distributive. In nationalising the banks the government would have a better chance at targeting the poor, who are in need of credit. In this regard, he mentioned Mexico which according to him was a step ahead of the world as they had nationalized their banks because it was the main source of their capital flows. However, Mexico was wrongly condemned for it and the subsequent de-nationalization led to a huge amount of corruption. While different institutions like banks, insurance companies and other financial institutions can exist, their prospects should be controlled by the government and a hierarchical structure needs to be maintained.

Abhijit Sen asked for Ajit Singh’s opinion on the idea that when there are too many markets, they destroy everything as against the Raghuram Rajan report that in India there are not enough markets and hence the existing one should not be closed down. Secondly, he asked for Ajit Singh’s take on the Indian market specially with regard to making Bombay an international financial centre, and on a recent article published in the Wall Street Journal which said that Europeans should make use of the great opportunity if Obama does decide to crack down on the US banks.

Ajit Singh responded by saying that there exists a large amount of literature regarding the need for existence of markets. According to the theory of incomplete markets, more information flows as the more complete the markets are and they result in a larger number of products being available. One of the arguments given is that if you have markets, there will always be people who would be looking to close it down so that they can retain their monopoly profits and hence the government should regulate it. Agreeing that it holds true in some cases, he said that it is not a general phenomenon. Indian conglomerates are idiosyncratic in nature and produce a large number of things. Thus they manage to be more profitable and efficient than the US conglomerates producing far fewer number of products. That could be a reason for the Indian market’s attractiveness.

Gabriel Palma said that he disagreed with Ajit Singh and felt that the financial system in the East Asian countries did have a lot to do with their development. Citing the example of Korea in particular, he said that the household sector surplus was around 10-11%, government expenditure around 3-4%, while corporate deficit was around 10% of the GDP, and the financial sector in these countries was doing what it was supposed to do, i.e. channel the household surpluses to the needy corporates rather than taking on a life of its own.

While agreeing with Gabriel Palma, **Ajit Singh** pointed out that the financial sector in these countries was still under the control of their finance ministries control and that the Korean companies were still under nationalised banking. In fact much of the corporate sector would have gone bankrupt had the banks not been nationalised.

Leonardo Burlamaqui said that while drawing up a global reform agenda for the financial system, one should study the regulatory practices in other countries which did not get affected by the financial crisis. Countries like Singapore and Taiwan were affected by the crisis in terms of their trade figures but as far as the financial sector was concerned, they were not affected. He thus stressed on the importance of studying different regulatory systems prevalent in the world.

Commenting on Jan Kregel's point about the terms under the GATS and WTO, he reiterated that reforming the financial system is a much harder task than just reforming the banking system precisely because it is much wider than the latter. Institutes like WTO give the impression of being mainly about trade but are actually about the financial implications of trade. He recounted as to how when interrogated by the principle investigator of the NGO, Public Citizen, Pascal Lamy failed to put up any defense for the current state of GATS, and also went to the extent of admitting that the WTO would not be in a position to threaten the US from doing what they were not supposed to do. He added that reforming GATS under WTO made sense and should be taken up seriously.

Abha Shukla asked for Jan Kregel's opinion about the feasibility and repercussions of the suggestion that the banks should make the capital adequacy requirement countercyclical so that the capital requirement increases during periods of boom and reduces during bust.

Jayati Ghosh asked Jan Kregel about the legal status of an Understanding as opposed to an Agreement and whether it could be open to arbitration. She also enquired as to whether it could be used as a master tool, i.e. something that can be done by the big countries but not the small.

Jan Kregel responded that Pascal Lamy was not an appropriate regulator but then the individual countries would get representation when setting up the arbitration body. He cited the example of the WTO case of Antigua vs. USA regarding online gambling. On capital requirement norms being such that it is countercyclical, Jan Kregel said that he wasn't in favour of it and there were other considerations that were more important. While bankers say that capital requirements should be such that they provide some sort of buffer for the risk of the fluctuations, this is only a second best option as it amounts to saying that nothing can be done about the volatility. Besides, providing capital on a countercyclical basis is tough task by itself. Moreover, the countercyclical system of providing buffer capital stock could not prevent crisis from happening in Spain. Thus, countercyclical capital requirements norms are not a preventive method. A better idea, according to Jan Kregel, would be things like simple leverage ratio and risk adjustment to regulate the flow of the capital etc.

Jan Kregel also said that financial regulation could come in different forms such as regulation on the basis of instruments, products or regulation on the basis of institutions themselves. Regulations should be applied as per the functions being performed by the institution rather than according to the category into which the institution falls. In the US, institutions lend to their subsidiaries who then lend forward. So, the regulator regulated the bank holding company while other regulators regulated the specific smaller sectors causing an immense regulatory chaos. Capital requirement norms were in fact an attempt to apply uniform regulations to all institutions. However, if banks are very different then the uniform regulation will only result in creating arbitrage operations and gains. Thus generalized regulations will not serve any purpose. Instead specific norms as per the specificity of the functioning need to be designed for any meaningful regulation.