Anti-Crisis: The Age of a New Paradigm?

Foreword by Marc Uzan

The world economic recovery has been slow and uneven from country to country and there were previously unseen profound problems that have not been dealt with efficiently. We are on a potential road towards a more fragmented world as significant advanced economies are characterized by recession and severe unemployment and emerging markets are becoming increasingly important as core drivers of growth. The global financial system and its key players are facing a major transition. It is a becoming challenge to understand the real magnitude of changes that the global financial architecture is curent undergoing. In fact, the international community is constantly trying to restore the financial channels to support global growth.

With the initiative to address the issue of fragmentation in the world economy, Republic of Kazakhstan as a member of the United Nations hosted the Anti-crisis Conference in Astana on May 23-24th 2013 under the auspices of the *VI Astana Economic Form* along with the support of *Reinventing Bretton Woods Committee*. The event was attended by over 2,000 participants from 120 countries. At this conference a wide range of issues were taken into account, all of which challenge the global economic growth. Emphasis was laid to bring together leading developing countries of the world economy that are playing a more significant role in the world's growth. A brief summary of proposals is presented in this newsletter, as per the roundtable discussions held there to etablish an anti-crisis declaration, which will serve as a future terms of reference for a more hopeful global financial system-resilient to shocks. The Kazakh government's invitation to unite the world economies to participate in the *g-global initiative* to provide a joint response to crisis stems from the desire to debate novel ideas in a new format of dialogue that would be most representative, influential and efficient to understand concerns pushed for by G20.

UPCOMING CONFERENCE

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Washington DC

"Coordination or Anarchy?"

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The Great Economic Transformation

The world economy is at the crossroads no resourceful regulatory mechanisms of the monetary system have been put in place. This time around the monetary institutions in advanced countries have proved to be too big to fail. The relationship between real economy and virtual economy still remains out-of-focus. From the crisis, it is of greater evidence that too much monetary leverage does not feed people. Stimulus has fallen short of hopes for growth. Resurrection of credit growth is important for a meaningful global economy. This cannot be forced through QE; or money multipliers. Credit is not flowing from banks, even those banks that were once considered highly sophisticated and well capitalized need corrections today. Fixing the overall economy requires ensuring that capital flows properly, confirming a comprehensive financial stability. This requires setting up new types of regimes to deal with vicissitudes. Like "Soft principles" in area of investment, i.e. sustainable investment that looks after participation of people, investors in and the environment they live in. In order to accompany the transformation, a set of guidelines or principles must be laid down, that would be acceptable to the community. Economics of efficiency is more significant these days, especially in advanced economies. It is all about labor markets and structural adjustments. Moving to a knowledge based economy is needed. Politicians don't know how to get reelected and it is politically difficult to coerce any significant change in times of crisis and subsequent social unrest. Instead of trying to be nostalgic about the old days, we must embrace any change and allot more time to perfect current mechanisms. Initiatives which open up opportunities for international inclusiveness of global economies to endorse cooperation must also be promoted.

The Role of Central Banks

The longstanding risks of monetary policy measures to stability include medium and long term bubbles and cheap capital flows and toxic asset bubbles. A major reconfiguration in advanced countries that employ nonstandard monetary measures is required to develop a framework of monetary policy tools that help deepen financial markets to absorb capital flows and create guard against negative global spillover effects. All of which can be achieved by central banks that are independent and forefront in the need for renewed structural policies, increased supervision and effective resolution.

The Euro Area

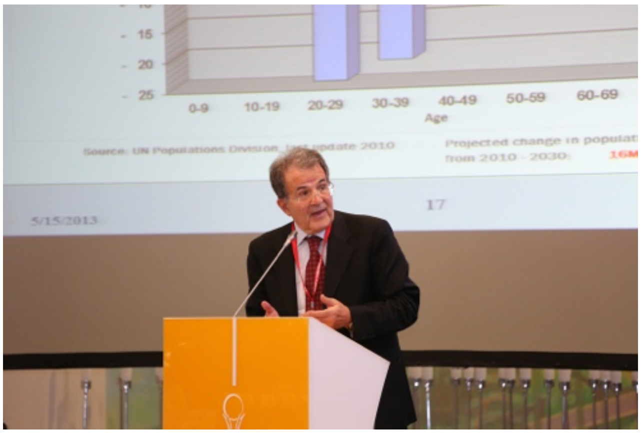
Current state of global economy looks better in many ways however it is characterized by broken monetary transmission and extreme tail risks. From fears of possible breakup to intensification of euro area crisis, the world economy has witnessed fiscal cliffs and addressed threats to financial stability. Immediate crisis resolution frameworks were put in place and financial markets have since recovered. Even the risky assets are doing much better today. However on the real side, global growth is still weak. Some of the themes that resonated are listed below.

- **Labor market:** Europe is heading towards total marginalization of a generation. Youth unemployment constitutes a long term social problem which is the root of instability. This is consequence of a rigid labor market. Flexibility is needed, particularly in periphery countries for employers to run business without too much regulation. A common minimum wage is to be set at appropriate level to encourage supply but not discourage job creation. A flexible job market is what helps job security. Long term unemployment a serious illness and direct consequence of a rigid labor market.

- **Competitiveness**: The real problem for Europe is the competitiveness. There is a blunt competitiveness gap between EU members further deepening their division into blocs more or less productive. At the same the individual national competitiveness is low. Europe's golden age has passed. To maintain the current standard of living, a lot of effort required, such as structural reforms like growth enhancing investments, drive for knowledge innovation and all of such measures that promote building enhanced competitive edge. Banks need to channel savings to such investments.

- **Banking Union:** Creating a banking union must be the immediate action. It is imperative to break the link between failing banks and troubled governments to improve structural functioning. Single bank supervisor under the European Central Bank (ECB) is due to be in place by mid-2014. However, action must be taken rethink measures to proceed with the resolution mechanism.

Forecast suggests that the transition from three-speed to full speed for the global economy will be slow. Financial conditions are still tight with many households continue to accumulate excessive levels of debt; explains some of the continued weakness to recovery in time ahead. Fiscal adjustment is easing and as economic prospects elsewhere improve, euro benefit area will improve. If continued policy support can address continued areas of weaknesses, Euro area should grow out slowly of constriction, and move to growth. But this talk about crisis doesn't apply to emerging markets. The growth has been home grown for EME's and there has been a slowdown in potential growth, especially with supply bottlenecks.



H.E. Mr. Romano PRODI,
Prime Minister of Italy (1996-1998, 2006-2008)

Emerging Market Economies

World economies are facing difficult test; balance between short term economic stimulus and long term fiscal consolidation. Advanced economies are focusing on recovering fiscal sustainability and major emerging economies with "fiscal space" need to contribute to this. EMEs need to be prepared of the risks of an external shock; global warning against negative spillovers from QE. EMEs themselves are required to brace for unpredicted shocks. (Orderly capital account liberalization, macro-prudential measures, financial supervision) EMEs must share growth with LDCs and help them to grow into becoming new emerging players of global economy.

The Role of G20

Global economy has experienced repeated financial crisis throughout history. Many were fielded by excessive leverage and often preceded by asset and credit booms that eventually turned into busts. The global economy has changed significantly since the creation of G20 because of the shift in economic power that it is now much more diversified. As the world faces a long period of adjustment, G20, along with multilateral platforms have entered a new transition period. When G20 was established, for 10 years, there was no serious crisis. It existed as an NGO that promoted aid packages than deliberate reforms. However post crisis, G20 met in April 2009, at a landmark conference in London and since then it has gained a new critical attention. That being said, the key issue remains the fact that it is difficult to take decisions when real players of the world are hard to bring together around the table to achieve consensus. Comparatively, it is impossible for G20 to truly deliver, major things as there is a clear need for power. G20 needs to have a secretariat, a technical body where people meet and work together. Why was the last change in Bretton woods in 1944? Because, the world is not one country, one structure anymore. Today the economy is more diverse, interdependent, yet contradictory and above all highly political. Though collective decision and political unity is difficult to achieve, improved coordination can be pushed for by significant economies.

Reforming the Bretton Woods institutions

Little efforts have been made to update or replace Bretton Woods since 1944. Today emerging market economies are trading more with themselves, they are gaining more weight in the global interactions. Half of the FDI flows around the world originate from EMEs. Macroeconomic reorientation is required to look at the set of macro policies driven by fiscal, monetary and income policies that can contribute to the shares of income. A machinery of international cooperation is required to prevent currency wars and instability caused by governance issues. All these call for reforms that must be stimulated by Bretton Woods institutions. By 2015, when the millennium goals will reach a deadline, the world community will need new ones. A global sustainable development agenda must be thus prepared that encompasses social, political and environmental issues as the key to all economic issues that are discussed at global level. Bretton Woods Institutions must assume to act as crisis manager and uphold consensus building.

Jacob FRENKEL,
Chairman JPMorgan Chase International

As emphasized in the above summary there is a clear need for renewed political and policy emphasis on reinforcing existing and developing new initiatives to keep up with the ever evolving macro economic realities as listed below:

1. There is a major, **Great Experimentation** and significant transformation under way in terms of the macroeconomic framework in advanced countries, which will have major consequences akin to the rebuilding of the global financial system after World War II.

2. **Debt overhangs**, significant macroeconomic distortions, adverse incentives for adjustments, and deficient governance structures in advanced economies risk causing an increasing fragmentation of the global economy. This state of play has created significant distortions in the global marketplace. Central banks' balance sheets have increased exponentially through net domestic asset creation in advanced economies, and net foreign asset creation in emerging markets has led to unprecedented monetary expansions.

3. Overall **global economic growth** still remains weak, despite the expansionary monetary policies adopted by some central banks. Their limited success in stimulating the economy may be attributed to the fact that the nature of monetary expansion is not favourable to credit expansion, with the monetary base being created mostly through collateralized flows on the basis of securities of deleveraging governments. Policy uncertainty remains very high, and the long-term repercussions of unprecedented, unconventional monetary stimulus, as well as the impact of eventual exit strategies, debt-servicing, global markets, and currency volatility, are yet to be completely known.

4. The **changes in the global economy** are profound, with structural, long-term implications. We are moving towards a new phase, witnessed by a shift in focus from the legacy of the crisis in the West towards the emerging and developing world. There are opportunities for global recovery and growth. Many American and European businesses are sitting out the recession with increasing amounts of cash. There is plenty of room for supply side driven growth if this liquidity were invested in R&D of new technologies, activities in which advanced economies have a clear comparative advantage. The expanding emerging economies that have enough savings to finance high rates of investments are absorptive markets for the technological and managerial services of the established multinationals and successful technological start-ups of the advanced economies. Other emerging economies with low rates of domestic savings, which create conditions to absorb financial capital from abroad will also become markets for advanced economies' technology and management. Reinvigorated global trade in capital goods and technological and managerial services could help to implement available technologies in emerging economies and spur global growth and progress. However, taking advantage of these opportunities requires a greater degree of economic strategy and policy coordination at the global level.

5. Sound medium-and long-term **fiscal management** provides greater policy room for shorter-term stimulus during economic downturns, of particular importance when an impaired monetary transmission mechanism hinders the effectiveness of monetary policy. Furthermore, countries with significant ("twin") current account and budget deficits and automatic stabilizers face the additional challenge of a lower fiscal multiplier during a down-cycle, at a time when a more accommodative fiscal stance would be required and more appropriate.

6. **Advanced economies** are projected to see their share in world GDP decline from 75 percent in 2000 to 54 percent in 2016 (IMF WEO September 2011). Emerging markets are projected to produce twice as much additional GDP on average through 2016 as advanced economies. The importance of emerging markets, as a driver of economic growth, a major consumer of goods, and increasingly as a global price setter and a rising repository of technological innovation, has not been consistently incorporated into economic analyses, market views, and policymaking. Emerging markets continue to be portrayed as disproportionately vulnerable to global economic trends, despite their remarkable resilience since the onset of the global financial crisis and growing importance and influence in shaping global trends.

7. The secular **forces of globalization** and the increasing weight of international trade as a share of total global economic activity, with the advent and growth of intra-emerging trade, further substantiate the growing importance of emerging and developing economies for the global economy, and warrant a greater voice and more equitable role for these countries within multilateral institutions and coordinated global policymaking.

8. Since the start of the millennium, many **emerging countries** have taken advantage of their healthier balance sheets and engaged in sterilized FX interventions, serving the dual purpose of minimizing local exchange rate appreciation and building reserves, which helped finance fiscal stimulus in the throes and aftermath of the global recession.

9. A profound transformation has been taking place in recent years in favor of **local currency bond markets** as an alternative, increasingly scalable means of financial intermediation for some emerging market countries. For domestic issuers, local currency markets reduce maturity and currency mismatches; for foreign investors, they potentially provide risk-adjusted returns superior to almost all global asset classes, with additional benefits from diversification. The market has seen impressive growth in market size and depth over the past decade, especially in developing Asia with the advent of the offshore RMB market based in Hong Kong and related dim sum bond market. Nevertheless, and despite strong growth across all emerging and developing regions, local markets remain largely concentrated in a handful of larger emerging countries.

10. The strong performance of **local currency bonds** over the last two years, despite tough exogenous challenges such as the US fiscal crisis and ongoing turmoil in the Eurozone, is at least as much an indication of the positive fundamentals of emerging economies and domestic bond markets' development and maturity as it is a reflection of exceptionally low yields in advanced countries; the former provide structural, longer-term tailwinds, whereas the latter may be cyclical in nature, and could provide potential headwinds in the event of "the Fed exit", for instance, causing excessive interest rate and exchange rate volatility.

11. In order to encourage and accommodate the development, growth and increasing **international integration of local markets**, where appropriate, steps must be taken to:

- ensure robust market infrastructures, with efficient and transparent clearing and settlements systems;
- develop standardized, liquid exchange-traded derivatives, in order to facilitate the hedging of, particularly but not exclusively, interest rate, currency, stock market, and local commodity risks;

- assure adequate market liquidity during both normal and exceptional trading conditions;
- clearly define rules, regulations, and oversight;
- develop and maintain transparent and efficient systemic-risk monitoring and management systems for both banks and domestic institutional investors, and a flexible yet predictable macro-prudential tool kit consistent with Basel III implementation;
- improve communication channels, information flow, and coordination between domestic and foreign regulators and policymakers;
- continue the ongoing international harmonization and alignment of financial reporting standards, corporate governance, and best practices.

12. The severity of the global financial crisis and ensuing **Global Recession**, the effects and repercussions of which are still being acutely felt by advanced countries, gave rise to a growing movement towards macro-prudential regulations, greater transparency and oversight, and active monitoring and management of systemic risk, with higher liquidity requirements and a more restricted role for leverage. Nevertheless, despite these positive steps, the great deleveraging and growing disintermediation of the US and Eurozone banking systems, along with the monetary Great Experimentations under way and the significant fiscal challenges ahead, all provide potential risks for future stability of the global financial system.

13. In the past, accumulated **currency reserves** were often passively held by some emerging countries as an insurance policy for times of distress. Today, given significantly diminished reliance on external debt for funding and vastly improved debt profiles, many emerging market central banks have become more active in managing reserves, for the purpose of judiciously providing market liquidity as, when, and where required and reducing exchange rate volatility. The latter, as a major determinant of local yields, carries significant implications for domestic price-, market-, and financial-system stabilities.

14. As such and in light of these new **macroeconomic realities** as well as past and recent experience, reserve formation and prudent management, with clear and responsible objectives and guidelines and appropriate frameworks, today have at least supporting roles to play in the prevention and mitigation of crises, especially as part of coordinative efforts. Recently, emerging market central banks have begun to establish direct, cross-currency swap lines in yet another indication of growing concerns about and diversification away from the US dollar and other major advanced reserve currencies. Deeper liquidity in and the potential coming of age of local currency bond markets, the increasing growth and importance of intra-emerging trade, greater intra-emerging collaboration and policy coordination, and generally lower net financing costs (“negative carry”) of reserves, all suggest a potential for the growing use of local currency bonds as reservable assets by emerging central banks as part of future reserves management, with positive implications for domestic growth.

15. Despite significant **exchange rate adjustments** since the global recession in 2009, current account imbalances remain an ongoing, long-term problem for the assurance of sustainable growth of the global economy. Greater efforts must be made towards internal rebalancing, by encouraging and promoting savings in deficit countries, and finding new, innovative, productive, and equitable solutions to meet the investment needs of surplus countries.

16. We vigorously urge and strive for the reduction of **social inequality** for all children, women and men, by enhancing social safety nets, tirelessly providing for the welfare and well-being of our citizenry during good and bad times, assisting in the promotion of their personal growth and development so they can lead happy, healthy, fulfilling, productive, and enriched lives.

17. **Education** is a key driving factor of individual, social, and economic development and growth. We uphold that it constitutes a basic human need and fundamental right, and acknowledge and affirm our responsibilities and engagement to provide the best possible education for our peoples, so that individuals and society as a whole may enjoy the benefits productivity, with higher quality jobs and income, as well as extensive, positive externalities.

18. Similarly, we strongly and actively support, encourage, and promote **collaborative scientific research**, as a means of fostering innovative solutions to long-term problems. The significant productivity gains derived from potentially revolutionary technological advances, in addition to enormous positive externalities, constitute not only tremendous economic benefits, but also significant advancement of human knowledge and achievement.

19. Finally, **scientific observations** and evidence corroborating global warming imperatively impose pressing challenges on humanity. Past neglect of the negative externalities bore out of environmentally-abusive economic and business practices must be immediately rectified, and we call for a commitment for greater research into "greener" practices and technologies, and increased efforts in formulating practical, effective, and sustainable adaptation strategies, in particular with regards to pragmatic applicability for emerging and developing countries

These proposals are a part of of the anti crisis declaration, the policy outcomes of which will be discussed at the VII Astana Economic Forum 2014: http://2013.astanaforum.org/en

These topics will also serve as key themes of RBWC's year-long project entitled "***Bretton Woods @70: The Age of a New Paradigm?***" As part of this project Reinventing Bretton Woods Committee will target outlining how the changing global economic landscape is altering the global financial architecture that has prevailed over the last decade. For more information write to info@rbwf.org