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| Global response to the global crisis |

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| Within hours of the US authorities realizing that their private housing bubble had burst and how severe the financial crisis and credit crunch had become, reverberations began to be felt all around the world. Stock exchange and exchange rate volatility erupted in several other global markets. This caused near panic among both private investors and governments. Rapid speculative financial flows traversed the globe in their trillions of US dollars looking for temporary sanctuaries and safe havens where they could be parked. There was such a feeding frenzy of speculation that observers feared the worst as the contagion of this panic spread. The herding behaviour of private speculators imitated the instinctive behaviour one sees when herds of cattle are prodded into action by forces they cannot comprehend. This is not the behaviour one expects from cool-headed rational investors. Immediately, several governments around the world took various emergency measures to protect their economies. Stock exchanges were closed, as in Russia. Short selling, (which I shall explain later in this series of columns) was temporarily banned. Central banks feared in particular what is termed “naked short selling.” Some governments like those in Ireland and Germany went so far as to provide guarantees for all banking deposits in order to prevent the disastrous outcome of what is universally feared:  a run on banks.As all these consequences unfolded the need for a coordinated global response became readily apparent. Largely, but not entirely, because the crisis had first erupted in the US, the authorities there initiated and subsequently led the efforts of global cooperation. First the US sought bilateral cooperation with its major trading partners, Canada, China, and Japan. Secondly, the US directed concurrent efforts to promote cooperation with other major industrial powers, especially, the G8 group of countries. Beyond a doubt, however, the most important area of coordination is that extended to the G20 group of countries.Although the crisis required responses that were way beyond the capacities of existing multilateral and international financial institutions like the IMF, the IDB and the World Bank, these institutions were kept fully involved in the search for solutions. Indeed they were expected to take the lead in coordinating policy changes affecting key financial instruments like interest rates, exchange rates and foreign reserves policies of national governments.For the remainder of this column I shall present readers with a summary description of the G20 and the key measures, which it has adopted to cope with the present and any likely future financial crisis or credit crunch.**What is the G20?**What is the G20? The G20 was formed in 1999 and comprises a group of finance ministers and central bank governors from among the world’s largest economies, both developed and developing, plus the European Union as a separate member. It includes membership from all continents and major regions: Africa, Asia, Australia, Europe, North and South America. Collectively the G20 accounts for over 90 per cent of the global GDP of US$67 trillion; 80 per cent of world trade; and about 70 per cent of the world’s population. The IMF and World Bank and two of their associated forums also participate in G20 meetings.The G20 is not a massive multilateral organization. It does not have a permanently staffed secretariat. It in fact manages its activities through what is called a ‘troika.’ That is, the current chair who is elected annually on a rotating basis from different regions, works with the future chair and the immediate past chair to provide a temporary administrative set-up for the chair’s term. This arrangement is expected to provide the needed management continuity in the absence of a permanent secretariat. As readers would realize from the description above this is a very representative global grouping. It includes the leading industrial economies of the G7, Russia, and all the major emerging economies.**G20 summit − key results**Several far-reaching results have been arrived at during the G20 Summit held on November 15. For the remainder of this week’s column I shall single out three of these for special mention in no particular order of importance. In next week’s column I shall elaborate further on the decisions made at the summit.One of the key results is an agreement to continue and enhance support for the process of continued WTO-led liberalization of world trade. This is considered critically important because if the present processes of globalization are halted now, the entire international system of market capitalism would certainly falter. Indeed the principal lesson to be learnt from the Great Depression (1929-1933) is that if during a global economic or financial crisis countries pursued what are termed by economists as beggar-thy-neighbour policies, this can bring world trade, investment, and financial flows to a screeching halt. These beggar-thy-neighbour policies would include competitive devaluation of currency exchange rates, the imposition of tariffs and quotas to keep out imports and protect domestic producers, or paying subsidies to national exporters in order to give them a competitive advantage.A second important result is the commitment of the G20 to pursue the reform of the International Monetary Fund (IMF) and the World Bank. The key aspects of this reform process identified are 1) substantial augmentation of the financial resources to be made available to these institutions 2) changes in their modalities, procedures and ways of doing business, especially in relation to the developing countries and 3) major changes to their structure of governance. In particular it was agreed that the emerging market economies of countries like China and India would be given greater roles in the decision-making and executive authorization of these institutions.The third reform that I would single out here is the commitment to the comprehensive overhaul of the regulatory, standards-setting and oversight of framework under which financial firms operate. This requires 1) changes to existing accounting rules 2) greater transparency of securitized assets 3) full independence and autonomy of rating and regulatory agencies and 4) guarantees for the disclosure, publication and dissemination of financial information by private and public bodies.As readers would be aware from the above, the general goal is to redesign the existing 20th century framework of financial regulation to a 21st  century one that is capable of monitoring and regulating financial firms in an age of mature globalization.In particular, an age in which finance is hyperactive and the size of global financial flows is several multiples of the size of global GDP.Next week I will continue with the discussion of this topic. |