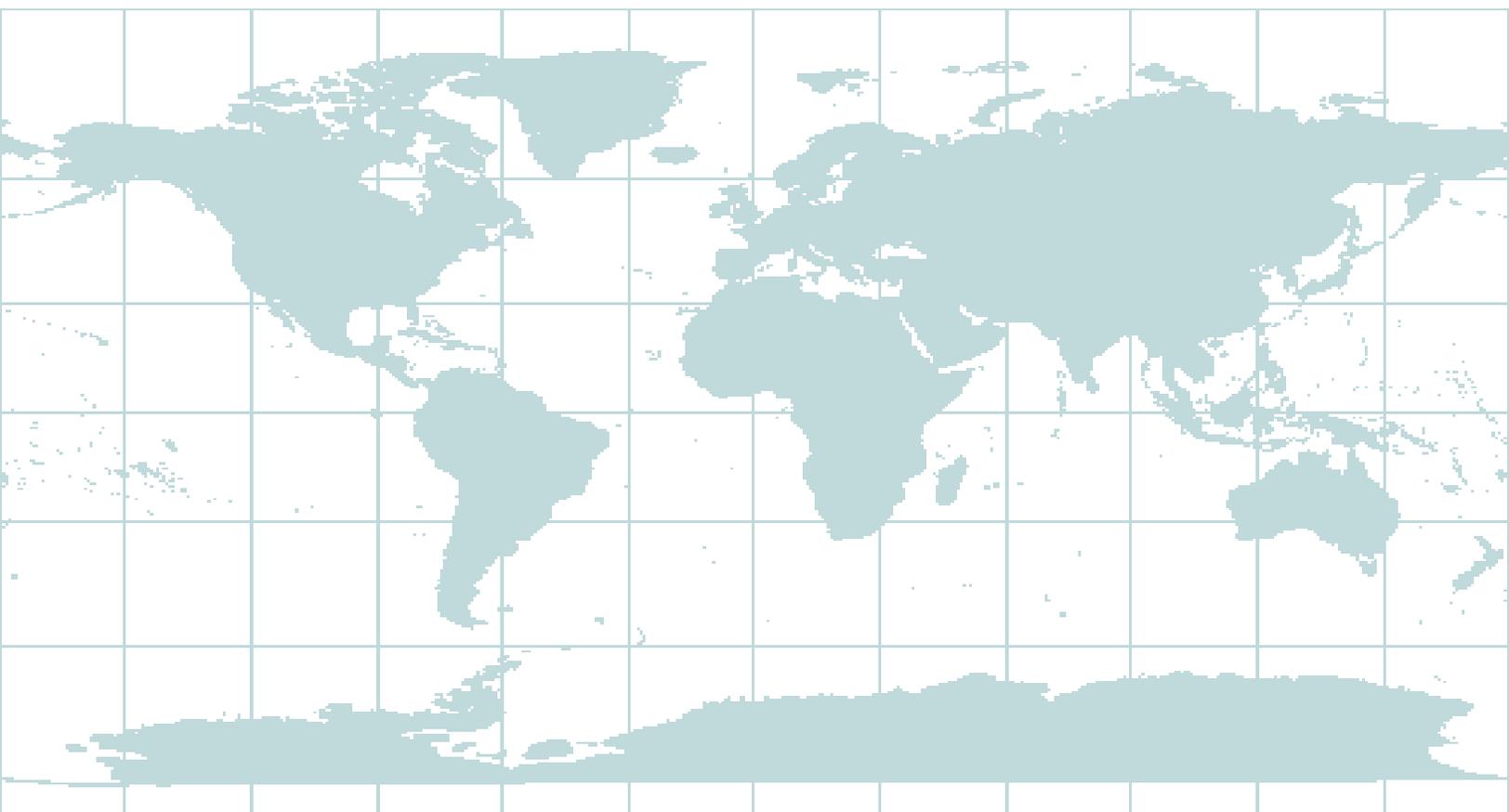


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Global Policy Model: An application

Coordinated and uncoordinated policy measures as the global financial crisis intensifies



United Nations
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Extract from *World Economic Situation and Prospects 2009: Update as of mid-2009*, pp. 14-19, available at: <http://www.un.org/esa/policy/wesp/wesp.html>

Policy challenges

Since the intensification of the financial crisis in September 2008, Governments worldwide have made massive public funding (amounting to \$18 trillion or almost 30 per cent of WGP) available to recapitalize banks, taking partial or full government ownership of ailing financial institutions and providing ample guarantees on bank deposits and other financial assets. Further, recognizing that monetary and financial measures will not be enough to stave off a recession, many countries have also adopted fiscal stimulus plans, totalling about \$2.6 trillion (about 4 per cent of WGP), but to be spent over 2009-2011. While significant, this may still fall somewhat short of the stimulus of 2-3 per cent of WGP *per year* that would be required to make up for the estimated decline in global aggregate demand.

More concerted action will be needed in four major areas.

- *First*, further decisive and cooperative action is needed to restore the financial health of banks, especially in developed countries. As indicated, despite the unprecedented support given so far, problems in financial sectors remain and additional efforts for adequate recapitalization of banks will be needed to facilitate resumption of domestic and international lending. Without this, the fiscal stimulus is not likely to be very effective.
- *Second*, the fiscal stimulus measures should be better coordinated and aligned with global sustainable development objectives. Thus far, there has been no true coordination of the fiscal measures being undertaken by national governments. Without adequate coordination, the stimulus measures may fall short of what is needed. Without coordinating the size and timing will limit the multiplier effects of the stimuli, thus reducing the impact on global economic growth and employment. Further, importantly, more than 80 per cent of the stimulus is being undertaken by the major developed countries. Facing a stronger downturn and with greater response capacity, most countercyclical efforts should indeed originate in those countries, but this does not ensure adequate rebalancing of the global economy. Moreover, since much of the stimulus will come from the major deficit countries, without corrective action, this would perpetuate the problem of the global imbalances (see box 2). Meanwhile most developing countries lack the resources to undertake needed countercyclical measures for their economies. While significant, the additional international liquidity to be provided by the international community as agreed by the “Group of 20”, is insufficient to give developing countries the resources they need to ensure a more balanced global stimulus aligned with long-term development needs.¹ Another concern is that many of the stimulus packages imply (often unintended) unfair trading practices by providing subsidies and incentives to domestic firms. The implication is that this may constrain recovery of economies that do not have the resources for fiscal stimulus and support to domestic industries. Global coordination should also deal with this concern.

¹ Much of the \$1.1 trillion would be allocated in accordance to existing quota in the IMF and most will be for short-term emergency lending, implying only a minor part will become directly available for long-term development financing in middle- and low-income developing countries. See also Report of the Secretary-General on the World Financial and Economic Crisis and its Impact on Development (A/CONF.214/4).

Simulations with UN-DESA's Global Policy Model suggest that a more balanced and coordinated global macroeconomic stimulus as suggested would yield significant global growth gains compared with a scenario of uncoordinated stimuli as implied by the existing fiscal stimulus packages being individually undertaken by national governments. In the coordinated scenario, the stimulus efforts by countries which now have large external surpluses would be larger than is currently the case, while additional resource transfers would be made available to developing countries for development financing (about \$500 billion extra over 2009-2012 compared with the uncoordinated scenario).² The additional resource transfers needed would include about \$50 billion for the LDCs. Apart from supporting the countercyclical responses of developing countries by strengthening of their social protection systems and making long-term investments in sustainable development, the coordinated scenario would also include concerted efforts to provide countries with greater access to developed country markets as envisaged in a truly developmental Doha Round of multilateral trade negotiations. In such a coordinated, development-oriented policy scenario, the world economy would recover to an annual growth rate of around 4-5 per cent in 2010-2015, led by robust growth of about 7 per cent per year in developing countries (figure 2). In the uncoordinated scenario, developing country growth would recover to only 3-4 per cent per year.

Developed countries clearly also gain from the proposed policy coordination and would see GDP growth accelerate to about 4 per cent per year, up from 2-3 per cent in the uncoordinated scenario. Furthermore, the simulation results for the coordinated policy scenario predict a benign unwinding of global imbalances, keeping external asset and liability positions of major economies in check, which would in turn support greater exchange-rate stability. The additional transfer of resources developing countries would thus seem to have a high pay-off worldwide. Of course, it will require, (global and national) conditions to effectively use them. Policy coordination needs to be accompanied by monitoring mechanisms to ensure accountability and this credibility for the concerted efforts.

- *Third*, fundamental reforms of the international financial system are needed to overcome the systemic flaws which caused this crisis in the first place and in order to guard against future crises. Without elaborating in detail here,³ such reforms should first deal with the major weaknesses in the regulation and supervision of the international financial system. Existing mechanisms are now generally seen as insufficient for mitigating the inherent pro-cyclicality of the financial system, which tends to foster asset price bubbles. A macro-prudential regulatory system needs to be created, based on countercyclical capital provisioning, to develop institutions for the supervision of all financial market segments concentrating systemic risk, including hedge funds and cross-border flows.

² The uncoordinated scenario is similar to the assumptions of the baseline forecast as presented in table 1, but adds the potentially adverse effects on global trade and its bias against developing countries of the protectionist elements contained in the stimulus and financial rescue packages.

³ See *World Economic Situation and Prospects 2009*, United Nations publication, Sales No. E.09.II.C.2; UNCTAD (2009) 'The Global Economic Crisis: Systemic Failures and Multilateral Remedies (UNCTAD/GDS/2009/1) and Report of the Secretary-General on the World Financial and Economic Crisis and its Impact on Development (A/CONF.214/4).

Strengthened international tax cooperation should form a critical element of a more effective global system of financial regulation. Such cooperation should help reduce tax evasion which is often linked with money laundering, corruption, financing of terrorism, and drug trafficking. As tax evasion is pervasive, improved tax coordination to combat it should also help boost the fiscal capacity of governments worldwide, which in turn would enhance financing available for recovery and development. For developing countries, it will be critical to establish an international mechanism for sovereign debt restructuring and relief based on a flexible approach towards debt sustainability while providing additional funding. As analyzed, the balance of payments of many countries is rapidly deteriorating because of the global crisis, while Governments will need to undertake massive countercyclical responses. Where needed, standstill agreements and temporary moratoriums on existing debt-payment obligations should be part of the package to give countries some additional financial breathing space. This would also reduce requirements for new funding. Beyond this immediate need for action, an orderly sovereign debt workout mechanism and an improved framework for handling cross-border bankruptcies are needed.

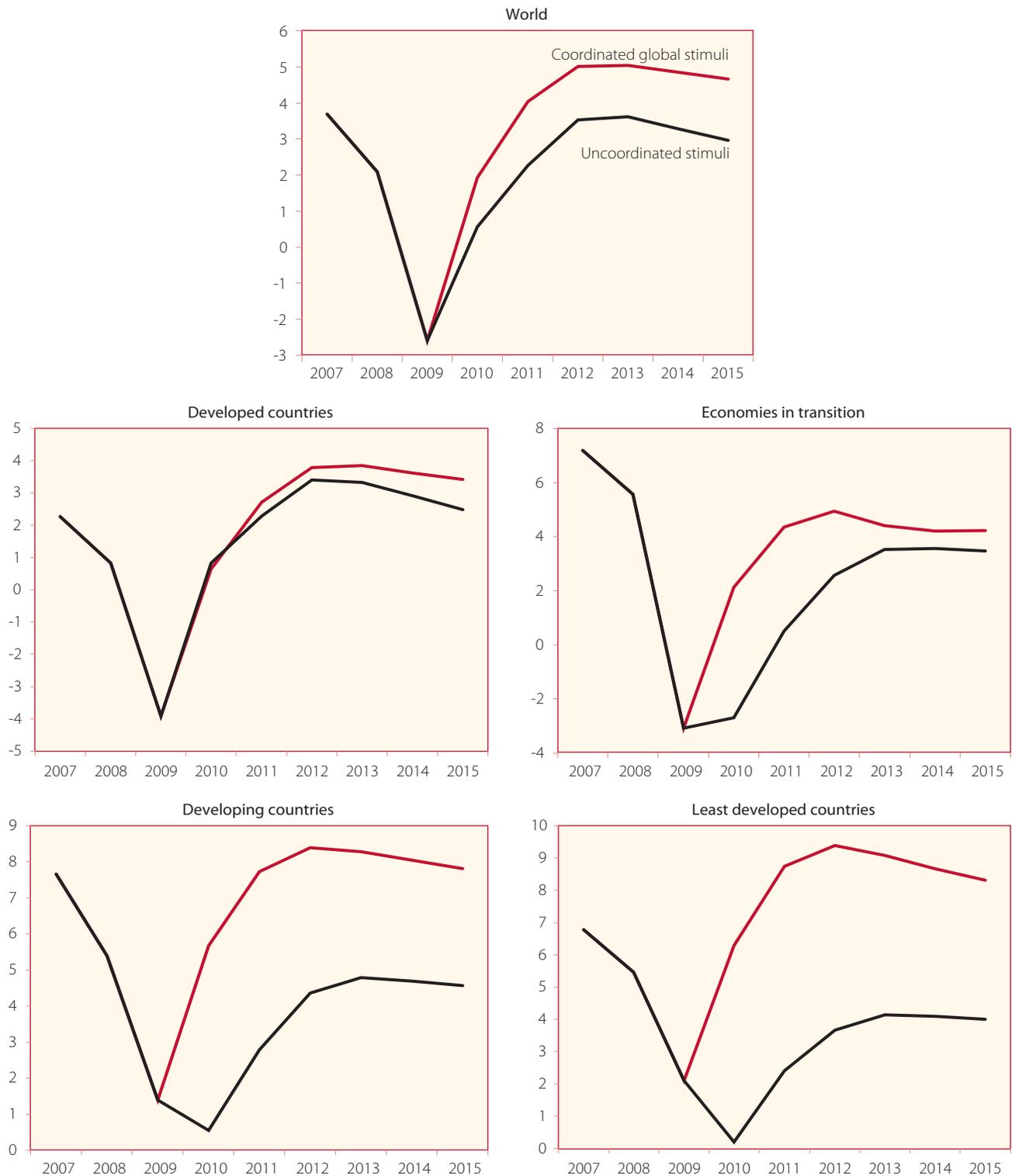
Most fundamentally, a new global reserve system which no longer relies on national or regional currencies as the major reserve currency must be created. Overcoming the major insufficiencies of the current system requires a set of broad reform measures. A new system which allows for better pooling of reserves at the regional and international levels and which is not based on a single or even multiple national currencies needs to be developed. It should permit the emission of international liquidity (SDRs or some equivalent thereof) so as to create a more stable global financial system. To make such a more prominent role of SDRs effective, it would need to be accompanied by further reform and policy measures.

- *Fourth*, a new framework for global economic governance in line with early 21st century realities needs to be created. Fundamental reform of the governance structure of the Bretton Woods institutions is needed. At the Doha Conference on Financing for Development, Member States agreed in December 2008 that such a reform must be comprehensive so that they can more adequately reflect changing economic weights in the world economy, be more responsive to current and future challenges and strengthen the legitimacy and effectiveness of these institutions. Existing inequities in voting weights in these institutions prevent them from incorporating the needs of users of their funds adequately in their operations and are in conflict with their public character and role as facilitators of international cooperation. These reforms should also lead to the establishment of a credible and legitimate mechanism for improved international coordination of macroeconomic policies. The global responses so far have been concerted at the level of the G7, G8, G20 or other ad hoc fora, lacking the participation or representation of important parts of the international community, especially from developing countries. Institutionalized macroeconomic policy coordination should be embedded in a more representative multilateral framework. The IMF could provide such a platform following adequate reform of its governance structure and revision of its functions.

Its policy making body, the International Monetary and Financial Committee (IMFC) could be tasked with mediating agreements of international policy coordination, including measures to guard against policies that can lead to unsustainable imbalances at the global level.

Broader global economic governance reforms must also be considered to ensure coherence in the global governance of the international financial architecture, the multilateral trading system, the framework for addressing climate change, the development agenda, and peace and security. Such coordination could take place through a new Global Economic Council that is part of the UN system, as proposed by some Member States, or through deep reform of the UN's Economic and Social Council. Whichever the mechanism, it is essential that a body be created which can provide coordination and oversight of responses to the broader range of global challenges and set the world on a new but sustainable development path.

Figure 2
Economic recovery under coordinated and uncoordinated global stimulus, 2009-2015



Source: UN/DESA, based on policy stimulations with the UN Global Policy Model.