Bretton Woods moment and evolving economic diplomacy

Monday, Nov 10, 2008

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For the global economy, the moment of truth is here. The old financial architecture has crumbled like a house of cards. The global system of trade and payments, set up in 1944 at Bretton Woods, may also need some facelift, if not a major overhaul.

Events unfolding around the world in the past few weeks are making a second Bretton Woods almost a foregone conclusion. Thanks to the latest financial crisis, there appears to be a growing convergence on the need for a new global economic order with the realization that the old order, having served well for over 60 years, is in need of substantial repair. World leaders also agree that this is no time for unilateralism. As such, we have seen a remarkably coordinated set of policy actions adopted across countries and regions focused on restoring confidence in the financial system and getting the wheels of banking and finance moving.

There are three simultaneous developments that need to be put in proper perspective.

First, a global conference of Group of Twenty (G20) leaders has been called in Washington on November 15. The European Union (EU) leaders have already met in Brussels to chart out a common position at the Washington summit. But questions are being raised about the effectiveness of a lame duck US President to provide the kind of leadership that will be necessary to forge agreements on contentious issues of which there will be many.

Second, there is no clarity as yet regarding the role to be played by the US President-elect, Barrack Obama, who has wasted no time to rally his team of experts to get on top of the economic agenda on which he is now placing the highest priority. The question that comes to mind is that if the Bush government’s policies of unbridled deregulation of financial markets are at the root of the present catastrophe, can it be relied on for a solution? Does the problem at hand allow the world to wait for a new US President to take office in January?

Third, there is the Stiglitz factor or, what might be termed as the US Treasury versus leading experts. The President of the UN General Assembly has summoned a panel of experts, headed by Nobel Laureate economist Professor Joseph Stiglitz, to study the crisis and come up with recommendations. As we know, Stiglitz and the latest Nobel Laureate economist, Paul Krugman, have been bitter critiques of the Bush policy of laissez faire in financial markets.

This raises the big question about who should be in charge of shaping a new global economic order, should that become necessary: the UN body with 192 member countries, or the G20 leading nations of the world who are assembling in Washington shortly. Here, quite apart from the issue of inclusiveness, there is the matter of forging decisions that can be carried through across the globe. A process under UN auspices could lead to the kind of impasse we have seen at the Doha Round under World Trade Organisation (WTO). Decision by consensus of all members — as is the case in WTO — could be a long time coming, or not at all. On the other hand, it seems a smaller group of twenty leading economies that includes India, China and Brazil, could be managed better for critical decisions. Bretton Woods I had brought together leaders of 22 western nations. But, insists Stiglitz, a global crisis requires global response, arguing that the UN body is the fit place for the next Bretton Woods.

Thus cracks seem to be appearing between the US Treasury and leading experts on the crisis. But it is the former that is driving the process of the Washington summit. For one, the US Treasury has been accused by some of ineptitude in, first, letting the crisis brew for over a year, and then coming up with a hastily prepared $700 billion package. The bailout package first took the wrong approach of buying out bad assets of banks, instead of providing capital infusion, which is what the European governments did, only then to be dittoed by Washington. I would hazard a guess that Professor Stiglitz, for all his expert insights on the current crisis, might be left out of the panel that will formulate the new global financial architecture. That would be a pity. I hope I am proved wrong.

Be that as it may, the evolving scenario is one of moving towards global financial reforms the shape of which is likely to be fleshed out in the days to come. There is clear agreement that everything will have to be done now to prevent the recurrence of such a global catastrophe in the future. Interestingly, Canada is the one country that is unwilling to go along with the notion of broad-based changes to the existing system. Rather, they would like to see current shortcomings of the regulatory regime to be addressed. This is not surprising as the International Monetary Fund (IMF) projects Canada to be the only Organisation for Economic Cooperation & Development (OECD) country to escape a recession in 2009, with a modest growth.

A critical geopolitical condition that the forthcoming summit must recognize is the shift in the balance of economic power, existing and projected. A number of emerging market economies like, Russia, China, Saudi Arabia, and some oil-exporting countries, have been accumulating persistent current account surpluses at the expense of high-spending consumers in North America and Europe. By one estimate, they have as much as $5.5 trillion among them, as compared to the $250 billion emergency fund with IMF. This “savings glut” in one part of the globe has been financing over-spending in another part. Indeed, some economists have blamed this “savings glut” for some of the excesses, such as lose monetary and credit policies in the debtor countries, permitted by the fact that big chunks of the surpluses were parked in US Treasuries and other financial instruments.

The asymmetry in global trade balance calls for a new approach to dealing with the current crisis – one in which countries like India, China, Saudi Arabia, and even UAE might have to play an integral part in the revival of the global economy. At the first Bretton Woods conference, only the US had surpluses that could be put to good use in the reconstruction of post-war Europe. Now the surpluses are elsewhere, but it is just as important to put them to good use in resuscitating the world economy and preventing a global depression. It is time all parties recognized the close interdependence of their economies. China simply cannot grow at a 10 per cent annual pace while US and Europe go into deep recession. Nor can small countries like Bangladesh achieve double digit export growth in those circumstances.

Finally, what about the stimulus package everyone has been talking about? This is a return to plain old Keynesianism with the only difference that the stimulus has to be global rather than national. Avoiding a protracted global recession will require globally coordinated efforts. This time around it will not be enough to devise fiscal stimulus (of, say, tax cuts, infrastructure spending, and unemployment compensation) in Europe and USA. There has to be similar packages for the BRIC countries (Brazil, Russia, India, China) and other emerging market economies.

While we don’t expect what is technically described as a recession (negative GDP growth) in Bangladesh anytime soon, a protracted global recession, if it occurs, could shave a few points off our 6.0-7.0 per cent GDP growth that we expect during the next two to three years. Both public and private investment and consumer spending will need to be sustained as part of a stimulus strategy to keep growth going. Unless we can discover a magic wand to achieve substantially higher Annual Development Programme (ADP) utilization in the coming years, our reliance would have to be on private consumption and investment spending. Since 2002, thanks to robust growth of remittances, our economy has been characterized by an excess of gross national savings over investment by as much as 5% of GDP! We remain an under-invested country, which is bad for a growing economy that is hungry for productive investment. Much of our remittance (savings of migrant workers) is going into consumption or less productive investment such as real estate. Given this backdrop, Bangladesh needs a stimulus package of a different sort, one in which these excess savings could be channeled into investment in infrastructure and the like. Innovation in our financial architecture will be needed for effectively intermediating between the excess savings we have and productive investments we need.