

Frontier Issues on Global Agenda Need for Global Cooperation

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Dr. D. Subbarao

Governor, Reserve Bank of India

Lessons of Crisis

Need for Global Cooperation

- Macroeconomic problems cannot be solved without global cooperation
- No country can be an island
- Uncoordinated responses will lead to worse outcomes for everyone

London G-20 Summit April 2009

A clear turning point
in global cooperation

Priority Task

To calibrate exit from the crisis driven
accommodative policies

and

put the world on a sustainable growth path

Is G-20 Unity Breaking Down?

Two main worries

- Inability of countries to resolve their conflicts of interest
- Inability to resolve the balance between medium term sustainability and short term compulsions

G-20 is Still Valid and Relevant

- World facing many complex problems with no easy solutions
- In a world of nation-states, no natural constituency for the global economy

Issues on the Global Agenda

- (i) Multi-speed recovery**
- (ii) Global adjustments – short term and medium term
- (iii) Protectionism
- (iv) International monetary system
- (v) Governance of Bretton Woods institutions
- (vi) Financial sector reforms

Multi-speed Recovery

- IMF raised global growth projection for 2010 from 4.6% to 4.8%
- EMEs - engine of growth and trade
- Advanced economies – slowing momentum of recovery

Multi-speed Recovery

Will EMEs be able to sustain global growth by themselves?

No, because

- Decoupling does not work
- EMEs are powerfully coupled with advanced economies
- In fact, coupling is getting stronger

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Global Adjustments

Short Term and Medium Term

Three interrelated issues

- Need for rebalancing across and within economies
- Role of exchange rates in redressing external imbalances
- Capital flows into EMEs

Global Adjustments

Short Term and Medium Term

(i) Rebalancing

- Internal rebalancing
- External rebalancing

Global Adjustments

Short Term and Medium Term

(ii) Exchange Rate

- Deficit economies – save more and consume less – need currency depreciation
- Surplus economies – save less and consume more – need currency appreciation
- Managing currency tensions requires shared understanding on keeping exchange rates aligned to economic fundamentals

Global Adjustments

Short Term and Medium Term

(iii) Capital Flows

- EMEs need capital flows to augment their internal resources
- Capital flows are triggered by both pull and push factors

Global Adjustments

Short Term and Medium Term

(iii) Capital Flows

Typical problems thrown up by capital flows

- Currency appreciation
- Asset price build up
- Hardening commodity prices

Global Adjustments

Short Term and Medium Term

Managing Capital Flows

- Intellectual Challenge: Need for a theory explaining the role of capital flows in determining exchange rates
- Practical Challenge: Shared understanding based on theory on two aspects:
 - To what extent are advanced economies responsible for the cross border spillover impact of their domestic policies?
 - What is the framework of rules governing currency interventions?

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Protectionism

- The orthodoxy that globalization is an unmixed blessing is being challenged
- Efforts of countries to resist currency appreciation are a manifestation of protectionist pressures

Protectionism

- Open protectionism resisted relatively well during crisis
- But opaque protectionism is on the rise
- Doha Round agreement could impart non-debt creating stimulus

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International Monetary System

- Single reserve currency – the US dollar
- US has met the obligations of an issuer of reserve currency by running twin deficits
- But these deficits caused imbalances that led to the crisis

International Monetary System

What are the Options?

- Replace the dollar by fiat?
- Build up the SDR as an alternative?
- Reduce need for self-insurance

International Monetary System

How to Resolve?

Need to explore
alternate options

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Governance of Bretton Woods Institutions

- Reforming governance structures of the IMF and World Bank
- Significant progress made in the World Bank
- Quota reform in IMF expected to be completed soon
- Need to continue the process of governance reform

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Financial Sector Reforms

- Basel III package
- Work in progress in Financial Stability Board

Conclusion

- Need for global cooperation in solving most pressing present day problems
- Purely national solutions inadequate and counterproductive

Conclusion

Is This Time Different?

- We should cooperate to exit from this crisis
- We should cooperate so as not to sow the seeds of the next crisis