ECONOMIC AND FINANCIAL
SECOND COMMITTEE

64TH GENERAL ASSEMBLY

Second Committee Special Event

Panel discussion on "Revitalizing the International Financial System"

Friday, 30 October 2009
10:00 a.m. – 1:00 p.m.
Conference Room 4

Provisional Programme

10.00 a.m. **Opening Session**

Welcome Remarks by **H.E. Ambassador Park In-kook,** Chairperson of the Second Committee of the United Nations General Assembly

10.05 a.m. **Panel Discussion**

Panelists:

Mr. Ranjit Teja, Deputy Director of the Strategy, Policy and Review Department, International Monetary Fund

Mr. Jeffrey Lewis, Senior Adviser and Head of the International Policy and Partnership Group (IPPG), Poverty Reduction and Economic Management Network, World Bank

Mr. Jomo K. Sundaram, Assistant Secretary-General for Economic Development, United Nations

11:30 a.m. **Interactive discussion**

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Concept Note

The world financial crisis has revealed major flaws in the international financial system. The outcome of the September G-20 Summit in Pittsburgh highlights challenges that have to be met in revitalizing the system.

Financial sector reforms must involve reshaping regulatory systems to better identify risks, expand the scope of regulation, reduce the procyclicality of prudential regulation, strengthen capital and risk management and reorient executive compensation principles to deter excessive risk-taking. The success of these reforms depends on coordinated international action to prevent financial institutions from exploiting regulatory advantage in a financially integrated world. The creation by the G-20 in April 2009 of the Financial Stability Board to monitor international action represents a positive step in this direction, although its membership is not inclusive of many of the developing countries most severely affected by the current crisis. Establishing international mechanisms to coordinate regulation and standards is an important long-term process.

The financial crisis underscores the need for IMF surveillance to maintain a sharp focus on risks in all systemically important countries, especially the reserve currency-issuing countries, and their potential spillover effects. To this end, the IMF vulnerability exercise is being expanded to advanced economies and integrated with the early warning exercise to be conducted jointly with the Financial Stability Board. Continued progress is required in improving surveillance over the major financial markets and advanced economies as well as better integrating macroeconomic and financial sector surveillance.

In the G-20 Summit in Pittsburgh, leaders called for a new era in managing global imbalances. The primary long-term goal of enhanced surveillance must be to ensure the stability of the international monetary system, notably through the reduction of global imbalances. This can only be accomplished if countries enhance their coordination in fiscal and monetary policies, paying attention to challenges in shifting aggregate demand from deficit to surplus countries. While the Pittsburgh commitments do not include the creation of enforcement mechanisms, it is more critical than ever to build an effective framework for enhanced multilateral surveillance and policy coordination.

In support of reducing global imbalances, a start needs to be made in the long-term reform of the present international monetary system, in which a national currency, the

United States dollar, serves as a dominant reserve currency. The goal should be a truly global reserve system that can provide a stable foundation to growing world trade and financing for development. This issue was discussed in the first summit of the BRIC countries (Brazil, Russian Federation, India and China), held in Yekaterinburg, Russian Federation, in June 2009.

Since the onset of the financial crisis, IMF has been provided large-scale financing to countries faced with a loss of external funding. IMF has made changes to increase flexibility of the overall lending framework to better meet the diverse needs of members, while remaining consistent with it original mandate. In support, the Group of Twenty and the International Monetary and Financial Committee of the IMF Board of Governors have agreed to a substantial increase in the resources of the Fund.

The World Bank Group's rapid increase in lending for development investment in middle-income and low-income countries in a range of sectors has been acknowledged by the G-20 and the Development Committee. They stressed the need for the Bank to develop its financial capacity to fulfill its mandate and to work with the regional development banks to enhance coordination and effectiveness. Both bodies committed to ensuring sufficient funding for the WBG to meet its challenges.

Addressing global economic governance issues is a prerequisite of revitalizing and reforming the international financial system. In this regard, leaders at the G-20 Summit in Pittsburgh and the International Monetary and Financial Committee at its 4 October 2009 meeting called for intensified governance reform in the IMF to enhance its legitimacy, credibility and effectiveness. They urged an acceleration of work on the IMF quota review to successfully change the distribution of representation to reflect the increasing weights of dynamic emerging market and developing countries in the world economy while protecting the voting share of the poorest members. G-20 leaders and the Development Committee similarly called for the World Bank to expedite the process of significantly increasing voting power of under-represented countries.

Proposed questions for consideration

How can international cooperation and coordination among national regulators be enhanced? Do proposals for a new multilateral mechanism merit serious consideration?

Should improved international coordination on fiscal, monetary and exchange rate issues be confined to global and supranational institutions or based on closer collaboration among national authorities? What should be the role of the United Nations?

How can multilateral financing mechanisms be further enhanced? Is the lending capacity of the international financial institutions adequate?

Is a truly global reserve currency a realistic and viable alternative? How can the use of SDR be promoted?

What are the best approaches to effectively address global economic governance issues?

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"Revitalizing the International Financial System"
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SUMMARY

Opening of the meeting

1. The meeting was opened by **H.E. Mr. Park In-kook,** Chairperson of the Second Committee. He welcomed the speakers and delegations to the special event. In his introductory remarks, Ambassador Park highlighted several main issues in revitalizing the international financial system and proposed a number of questions for consideration. The concept note of the panel discussion and panelist presentations, where available, can be accessed at www.un.org/esa/ffd.

Panel presentations

2. The panelists were: Mr. Jomo K. Sundaram, Assistant Secretary-General for Economic Development, United Nations; Mr. Ranjit Teja, Deputy Director of the Strategy, Policy and Review Department, International Monetary Fund (IMF); and Mr. Jeffrey Lewis, Senior Adviser and Head of the International Policy and Partnership Group (IPPG), Poverty Reduction and Economic Management Network, World Bank.

3. **Mr. Jomo K. Sundaram** noted that the problem of unsustainable global imbalances goes back to 1971 when the Bretton Woods system collapsed. Since then, a kind of non-system has emerged, characterized by deregulation, including capital account liberalization, and self-regulation. However, financial globalization, while increasing instability, has not contributed to investment or economic growth, with developing countries as its innocent victims. In this process, financial liberalization has been much more significant than trade liberalization and fixed capital formation has exhibited a downward trend. Greater financial volatility has also contributed to the outflow of resources from developing countries, with short-term capital flows particularly problematic. The speaker also stressed that there was a failure of the system in anticipating the current crisis.

4. The current crisis has had a dramatic impact on developing countries in terms of stock market collapse, a reversal of capital flows, rising borrowing costs and exchange rate volatility. Financial crisis has quickly spread to real economy and led to a serious deflationary spiral and, unlike 1970s crises, all parts of the world have been affected through trade and financial impact. Policy response to crisis has not been adequate, with double standards being applied to developed and developing countries, particularly in constraining fiscal policy space.

5. The emergence of the G20 as the center of international crisis management has marginalized the Bretton Woods institutions (BWIs) and presents major challenges, both to the BWIs and the UN system in general. G20 membership is not representative of developing countries and its mandate includes neither developmental nor equity objectives. In this regard, the speaker recalled that the 1944 UN Conference on monetary and financial affairs was an

inclusive multilateral attempt to establish a new international monetary order as well as to address ways to sustain growth, job creation, trade and reconstruction. There is a need now for a similarly broad reform agenda to ensure greater inclusiveness and to include developmental and distributional mandates in the international financial system. In this regard, the Stiglitz Commission report proposed a Global Economic Coordination Council as an alternative to the G20. The Commission also recognized the need for new international financial facilities, a new international reserve currency, a debt restructuring tribunal and international commission on tax cooperation at the UN. There is also a need for new policy surveillance mechanism independent of the IMF to deal with capital account management.

6. **Mr. Ranjit Teja** stressed that one of the most important results of the crisis has been unprecedented strengthening of international cooperation in economic policy coordination, financial regulation and multilateral provision of financing. The crisis has brought to the fore the need for a global economic council to make decisions on policy coordination. The G20 has *de facto* assumed that unprecedented role with huge success because of the involvement of world leaders. Unlike the G20, many supranational agencies have not been effective because coordination arrangements are fundamentally national.

7. The second area of coordination is financial regulation. It is important to address the tension between the global nature of finance and the national basis of regulation. As the world is not yet ready for global regulation, there should be more coordination, but not a supranational regulatory body. The expansion of the Financial Stability Board to cover all the G20 members has greatly increased the scope for cooperation. The third area is cooperation in delivering financing. Here, IMF lending capacity has been tripled. Although actual commitments account for only one-third of new capacity, what is important is the security of having standby credit available. Whether to expand the capacity further is still an open question.

8. On the issue of a global reserve currency, the speaker noted that there have been proposals to move from the dollar to a currency supplied by a global institution. The importance of reserve holdings has been evidenced in this financial crisis, unless the world has a credible lender of last resort. The IMF is moving in the direction of increased lending with reduced conditionality to provide a substitute for excessive reserve accumulation. There have also been proposals for the IMF to increase the issuance of Special Drawing Rights (SDRs) but the IMF is not structured to be an issuer of a global currency. Currently, there are organic substitutes, primarily the euro, to the dollar. It can be expected that the progress to an alternative reserve currency will be long-term and slow. The most important policy concern is that the process of diversification of reserve holdings should not be chaotic or unstable.

9. **Mr. Jeffrey Lewis** stressed that revitalizing the international financial system is a task for many years to come. The world has had a series of crises: food and fuel price shocks and the financial crisis in advanced countries that spread quickly from the US around the globe. The financial shock quickly spilled over to the real sector, producing a global recession. As the impact of the crisis and the channels of transmission differ across the countries, there should not be any single solution to deal with the crisis.

10. The speaker singled out one implication of the crisis: the adaptation to new realities will continue long after growth resumes. First, the crisis has produced humility in terms of predictive capacity as the policy making world missed the signs of the coming crisis. Second, there has been a shift in the role of government from lender of last resort to insurer or investor of last resort. Third, fiscal and monetary policy frameworks have fallen apart so that monetary and fiscal authorities have had to change the rules. Fourth, rethinking of financial sector liberalization is under way.

11. The speaker also stressed that the crises have highlighted weaknesses and gaps for developing countries in the global financial system that require attention. First, there is the higher vulnerability of middle- and low-income countries to erosion in access to finance, unrelated to underlying fundamentals. Second, the international trade system has exhibited vulnerability to the lack of trade finance. Third, developing countries have had difficulties in mobilizing substantial quick-disbursing financing on appropriate terms to augment and support counter-cyclical fiscal policies. Consequently, there is a need to equip multilateral development banks over the medium term to better assist countries to respond to future crises. The speaker recommended an increase of IBRD and IFC capital, the replenishment of IDA to deal with current crisis and future demands, as well as the design of new instruments, such as the IDA Crisis Response Window to complement the existing aid architecture.

Interactive discussion

12. Following the panel presentations, an interactive discussion took place between the panelists and delegations. Salient points of the discussion are summarized below:

- Several delegates and panelists highlighted the moral obligation to compensate poor countries for the adverse effects of the world financial and economic crisis, which originated in the developed world. Moreover, they further underscored that it was in the developed world's self interest to help these countries since they had been engines for global economic growth previous to the crisis. The BWIs and the UN could play a critical role in monitoring the implementation of development commitments and in the promotion of international transparency. The IMF highlighted that it had sharply increased its budgetary support to middle- and low-income countries and had called for stimulus packages as early as January 2008.

- Some of the discussion centered on the question of the type of policies that could help to reduce global imbalances, and, more specifically, how net transfer of financial resources from developing to developed countries could be reversed. Speakers emphasized that there was a responsibility of surplus countries to introduce polices that did not lead to excessive reserve accumulation. However, a credible lender of last resort was needed to ensure the provision of adequate financial resources in times of crisis.

- Several speakers discussed the concept of an international currency transaction tax or similar levies at the national and international levels. They referred to a cross-border financial transaction tax that would rest on the original principle of the Tobin Tax to prevent excessive speculation, as well as the idea of a domestic financial transaction tax that could reduce volatility and generate revenue for countercyclical policies. An IMF study on this subject for publication next spring approached the tax more like an "insurance tax" that would generate funds for potential rescue packages of the financial sector.

- With regard to the potential introduction of a new global reserve currency, it was emphasized that there was currently no adequate structure in place that could manage such a device; the IMF was certainly not equipped to do this. Moreover, much depended on the political will of the international community to diversify from the US dollar.

- Several delegates asked for clarification on the exact relationship between the decision-making processes in the G20 and the BWIs. The response given by the IMF was that the BWIs provided technical input to G20 meetings. Nevertheless, given the fact that the G20 countries generated more or less 85% of world GDP, they also had a large say in the IMF and World Bank, in view of their current governance structures. Other speakers underscored that, whereas the relevance of the BWIs lay in their major commitment to multilateralism, the need to prioritize development was often compromised by their inequitable governance system.

- The IMF surveillance of developed countries was criticized as inadequate. Several speakers wondered how far the conventional wisdom related to international financial regulation and the disconnect between the financial sector and real economy had changed because of the crisis. Delegates inquired about the potential of the UN to help reform and revitalize the international financial system. Whereas the Outcome of the UN Conference on the World Financial and Economic Crisis and Its Impact on Development provided important impetus, the envelope may have to be pushed further. For example, reinstating the Glass-Steagall Act of 1933 would be one possible step to reduce the disconnect between the financial sector and real economy.

- Some speakers acknowledged the greater inclusiveness of the G20 compared to previous bodies such as the G7. Moreover, the G20 also provided room for representatives from intergovernmental organizations at the regional and international levels, which has included the UN. Yet, many delegates called for a more legitimate council. Reference was made to the proposal of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System to establish a Global Economic Coordination Council. The challenge lay in the specification of a model that would harmonize efficiency with legitimacy and could effectively ensure overall coordination of the world economy. Some speakers stressed that members of a new council should represent regional groups to enhance the legitimacy of the new mechanism.