UN Intellectual History Project

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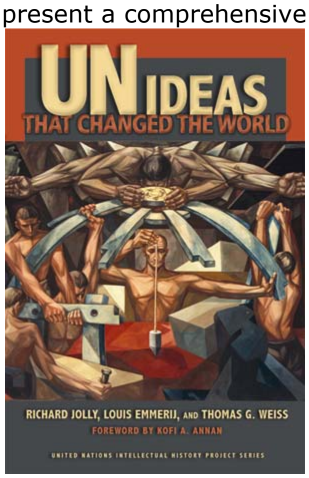
# The UN and the First Economic and Financial Crisis of the Twenty-first Century

When we wrote the capstone volume of the United Nations Intellectual History Project, *UN Ideas That Changed the World,* the "Great Recession" had just started and it was difficult to present a comprehensive picture of the crisis itself and of the UN's reaction to it. However, we did write the following at the outset of the book: "As we finalize these words in February 2009, the whole world is engulfed in recession and in an economic and financial meltdown, yet coordinated international action plans have not even started. The risks and uncertainties make attempts to look forward even more hazardous than usual. Yet we have maintained the future orientation in this volume, and we are even more persuaded than we were at the beginning of the project that the world organization has a major role to play in responding to the present difficult and delicate situation" (xix).




Since then the shape and impact of the global crisis has become somewhat clearer—though not entirely clear. The crisis is still with us, though some recovery is underway in many parts of the world, especially in Asia. In developed countries, massive increases of public expenditure have restarted growth and enabled most banks to recover and even to restart paying billions in bonuses. But unemployment is still very high, and growing levels of public debt are raising fears of currency collapse in some countries—Greece, at the time of writing, most notably—and of "a double dip," a further decline in gross domestic product after the two or three quarters of gains resulting from the initial Keynesian boost to expenditure.

Economic data on the world's poorer regions is neither complete nor up-to-date; and statistics on employment, health, nutrition, and other human indicators are decidedly patchy. It is therefore difficult to obtain a truly global perspective of the economic and human setbacks. Notwithstanding incomplete data, it appears that different parts of the world have been affected in very different ways. In Asia, as mentioned, economic growth dipped for a few months but has largely recovered, in part because of robust state action funded by reserves accumulated after the 1997–1998 Asian financial crisis. In Latin America, Africa, and the Middle East, a number of countries seem to have weathered the storm, especially those with oil or with mining reserves, but many others are suffering.

Some part of the positive balance sheet undoubtedly can be attributed to the coordinated recovery efforts of the Group of 20 (G-20), a forum of the world's richest countries (measured by gross national product [GNP]), both developed and developing. The G-20 had been brought together as an *ad hoc* assembly of the leading economies (accounting for 90 percent of world GNP) whose meetings are formally convened outside of the UN or the Bretton Woods organizations. Inviting World Bank and International Monetary Fund (IMF) representatives and relying on the IMF, in particular, for channeling most of the resources mobilized by the G-20 is standard practice. However welcome and important its activities, the G-20 has mostly responded to the interests of the major powers and has failed to represent and respond adequately to the needs and concerns of the 172 countries excluded from formal representation. Although reform of the international system was mentioned in these meetings, most of the emphasis was on increasing Africa's representation in the boards of the IMF and the World Bank over the next few years, not on reforming their way of doing business or of the underlying paradigm that guides their operations.

This briefing note summarizes the UN's activities in the year since our capstone volume went to press, mostly summarizing the recommendations and conclusions of the expert commission set up by the president of the General Assembly. We conclude with a somewhat dismal summary of the lack of action since September 2009.

## The UN and the Stiglitz Commission

The United Nations has made some important efforts to take a broader view, responding to an initiative of the president of the sixty-third session of the General Assembly, Miguel d'Escoto Brockmann, who convened a global conference in June 2009. In preparation, he set up a commission, with the Nobel prize-winning economist Joseph Stiglitz as its chair, to analyze the global situation and make recommendations for national and international action.

The Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System (hereafter the Stiglitz Commission) was composed of economists, policy makers, and practitioners drawn from Japan, Western Europe, Africa, Latin America, and South and East Asia. It submitted its recommendations to the world body in March 2009. They were discussed at a special session of the UN in June and by the General Assembly in September 2009.

Not surprisingly, the Stiglitz Commission took a broad and bold view of the crisis and of the national and international actions required for recovery and, in particular, the actions needed to ensure support and recovery for poorer developing countries. The commission recommended both immediate measures of action and deeper measures for systemic reform.

### Immediate Measures to Improve the Functioning of the Global Economic and Financial System in the Short Run

Among the Stiglitz Commission's more immediate measures for action were the following key six recommendations:

- **All developed countries should take strong, coordinated, and effective actions to stimulate their economies**

Stimulus should be timely, have large "multipliers," help address the strains posed by the economic downturn on the poor, help address long run problems, and prevent instability. While the decision on stimulus is national, it should be judged on its *global* impacts; if each country looks only at the national benefits versus costs—e.g., an increased national debt—the size of the global stimulus will be too small, spending will be distorted, and the global impact will be eviscerated. National stimulus packages should thus include spending measures to be undertaken in developing countries to offset the impact of the decline in world trade and financial markets. Industrialized countries should thus dedicate 1.0 percent of their stimulus packages, in addition to traditional official development assistance commitments.

- **Developing countries need additional funding**

More permanent and stable sources of funding for developing countries are needed, notably ones that could be activated quickly and are not subject to inappropriate conditionality. Indeed, additional funding would be required just to offset the imbalances and inequities created by the massive stimulus and bail-out measures introduced in advanced industrialized countries. Such funding could be provided by an issuance of Special Drawing Rights (SDRs) approved by the IMF Board in September 1997 through the proposed Fourth Amendment of the Articles of Agreement to double cumulative SDR allocations to SDR 42.8 billion and through the issuance of additional SDRs through standard procedures.

- **Mobilizing additional development funds by the creation of a new credit facility**

The creation of a new credit facility is a matter of urgency. If such a facility could be created in a timely way, it could be a major vehicle for the disbursement of the requisite additional funding. Given the need for rapid response, the new credit facility might be more quickly established under the umbrella of existing institutions, such as the World Bank.

- **Opening advanced country markets to least developed countries' exports**

While a successful completion of the Doha trade round would be welcome, its impact on the crisis and its development dimensions remain unclear. There are, however, a number of measures that have already been agreed upon in multilateral trade negotiations that could be implemented rapidly to support developing countries affected by the crisis. These include implementation of duty-free, quota-free market access for products originating from least developed countries. In addition, immediate implementation is needed of the agreement reached at the World Trade Organization's Hong Kong Ministerial session in 2005 that provided for the elimination of all forms of developed country export subsidies, at the latest by 2013. There is no reason to await a general agreement before implementing these measures. In addition, abolishing cotton subsidies should be immediate, as they distort prices to the detriment of African countries. More generally, the long recognized principle of special and differential treatment for developing countries should be preserved in all trade negotiations.

- **Beginning work on regulatory reform, while learning from successful policies elsewhere**

The financial crisis is widely viewed as the result of the failure of regulatory policies in advanced industrial countries. While full regulatory reforms will take time, it is imperative that work on regulatory reform begin now. The collapse of confidence in the financial system is widely recognized as central in the economic crisis; restoration of confidence will be central in the recovery. But it will be hard to restore confidence without changing the incentives and constraints facing the financial sector. It is imperative that the regulatory reforms be real and substantive and that they go beyond the financial sector to address underlying problems in corporate governance and competition policy, and leverage requirements. Even if there had been full disclosure of derivative positions, their complexity was so great that an evaluation of the balance sheet position of the financial institutions would have been extraordinarily difficult. Still, there is need for much greater transparency, including forbidding off balance sheet transactions.

- **Improving coordination of global economic policies**

There is a need for substantial improvement in the coordination of global economic policy. Global economic integration has outpaced the development of appropriate political institutions and arrangements for governing the global economic system. Remedying this lacuna is a matter of urgency, but this will not happen overnight. In the short term, an appropriate mechanism should be created within the UN system for independent international analysis on questions of global economic policy, including its social and environmental dimensions. Following the successful example of the Intergovernmental Panel on Climate Change, a similar panel could be created to offer expert views to the General Assembly and ECOSOC, as well as other international organizations, in order to enhance their capacity for sounder decision-making in these areas. At the same time, such a panel would foster a constructive dialogue and offer a regular venue for fruitful exchange between policy makers, the academic world, and key international organizations.

### Systemic Measures to Reform the Global Economic and Financial Architecture over the Longer Run

The Stiglitz Commission also formulated recommendations about longer-run measures. We list the following essential nine measures:

- **A new global reserve system**

Global imbalances played an important role in this crisis. They can only be addressed if there is a better way of dealing with international economic risks facing countries than the current system of accumulating international reserves by each country on its own. This was done in East and Southeast Asia after the 1997 crisis. Indeed, the magnitude of this crisis and the inadequacy of international responses may motivate even further accumulations. Inappropriate responses by some international economic institutions in previous economic crises have contributed to the problem, making reforms of the kind described here all the more essential.

To resolve these problems, a new global reserve system is needed. This may be viewed as greatly expanded SDRs, with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations, which could contribute to global stability, economic strength, and global equity. Currently, poor countries are lending to the rich reserve countries at low interest rates. The dangers of a single-country reserve system have long been recognized, as the accumulation of debt undermines confidence and stability. But a two (or three) country reserve system, toward which the world seems to be moving, may be equally unstable. A new global reserve system is feasible, non-inflationary, and could be easily implemented, including in ways that mitigate the difficulties caused by asymmetric adjustment between surplus and deficit countries.

- **Reforms of the governance of the international financial institutions**

There is need to reform the governance, accountability, and transparency of the Bretton Woods institutions and other non-representative organizations that have come to play a role in the global financial system—such as the Bank for International Settlements and its various committees, and the Financial Stability Forum. Deficiencies in their governance have impaired the ability of these institutions to take adequate actions to prevent and respond to the crisis. The policies and standards adopted or recommended by them have often been to the disadvantage of developing countries and emerging market economies. Major reforms in the governance of these institutions, including measures that give greater voice to developing countries and greater transparency are thus necessary.

- **The Global Economic Coordination Council—a democratic alternative to the G-20**

A globally representative forum to address areas of concern in the functioning of the global economic system in a comprehensive way must be created. At a level equivalent with the General Assembly and the Security Council, this global economic council should meet annually at the heads of state and government level to assess developments and provide leadership in economic, social, and ecological issues. It would promote development, secure consistency and coherence in the policy goals of the major international organizations, and support consensus building among governments on efficient and effective solutions for issues of global economic governance. Such a council could also promote accountability of all international economic organizations, identify gaps that need to be filled to ensure the efficient operation of the global economic and financial system, and help set the agenda for global economic and financial reforms. It would be supported intellectually by the work of the international panel proposed above. Representation would be based on the constituency system and designed to ensure that all continents and all major economies are represented. At the same time, its size should be guided by the fact that the council must remain small enough for effective discussion and decision making. All important global institutions, such as the World Bank, IMF, World Trade Organization, International Labour Organization, and the UN Secretariat would provide information and participate in the council. It could thus provide a democratically representative alternative to the G-20.

- **Reforming central bank policies to promote development**

Price stability is desirable in support of growth and financial stability, but it is not sufficient. Central banks should therefore aim to ensure price stability in the context of delivering long-term sustainable growth while being sensitive to the risks to financial stability, capital flows, and exchange rates. Central banks also need to give consideration to financial market and asset price developments. This may entail central banks' use of a wider range of instruments, including prudential ones. A distinction may need to be made between the roles of central banks in maintaining financial stability under normal circumstances and during crisis periods.

- **Financial market policies**

Financial policies, including regulation, have as a central objective not only ensuring the safety and soundness of financial institutions and the stability of the financial system, but also the protection of bank depositors, consumers, and investors. They also have related other objectives, such as facilitating access to banking services, including credit on reasonable terms and the provision of financial products that help individuals and families manage risks. It is also imperative to ensure that the sector is competitive and innovative.

Financial institutions have been allowed to grow to be "too big to fail," thereby imposing enormous risk on the global economy. Not only has innovation has been lacking, but too attention has been paid to meeting the real needs of ordinary citizens. Too little was done to help developing countries and ordinary homeowners manage the risks that they face, with consequences that the crisis has made only too apparent. Financial regulation should be designed so as to enhance meaningful innovation that improves risk management and capital allocation.

The current crisis has made it obvious that there are large gaps and deficiencies in the regulatory structures of many systemically significant countries. It is also apparent that while effective regulatory systems must be national there must be some *global* regulatory framework to establish minimum national standards and also to govern the operations of relevant global financial institutions.

- **Toward global institutional arrangements for governing the global economy: the need for a Global Financial Regulatory Authority and a Global Competition Authority**

The Financial Stability Forum was created in the aftermath of the 1997–1998 financial crisis in order to promote international financial stability, improve the functioning of financial markets, and reduce the tendency for financial shocks to propagate from country to country. It is now apparent that the forum's proposed reforms, although important, have been insufficient to avoid major global financial instability. If it is to become the main instrument for the formulation of systemic reforms, it must take into consideration the importance of financial stability for the development of the real economy, the representation of developing countries to adequately reflect their views; and accountability to such democratically representative institutions as the proposed Global Economic Coordination Council.

The development of financial institutions that are too big to fail has played an important role in the development of the crisis and has made its resolution difficult and costly, both for taxpayers and for the global economy. It is imperative not only that there be adequate oversight of these large institutions but that efforts be made to limit their size and the extent of their interactions in order to limit the scope of systemic risk. This will require more effective global cooperation in financial and competition regulation. Movement toward this goal might be enhanced by taking steps to lay the groundwork for a Global Financial Regulatory Authority and a Global Competition Authority. With so many firms operating across borders, it is difficult to rely on national regulatory authorities only. There may be large externalities generated by the action (or inaction) of national authorities. A potential, but partial, remedy to this difficulty is the proposal for a College of Supervisors to oversee systemically relevant global financial institutions.

- **Mechanisms for handling sovereign debt restructuring and cross-border investment disputes**

There is also an urgent need for renewed commitment to develop an equitable and generally acceptable Sovereign Debt Restructuring Mechanism, as a well as an improved framework for handling cross-border bankruptcies. This could potentially be accomplished through the creation of an independent structure, such as an International Bankruptcy Court. The United Nations Commission on International Trade Law provides a model that could be extended to the harmonization of national legislation on cross-border disputes dealing with trade in financial services.

A number of countries may face difficulties in meeting their external debt commitments as the crisis worsens and debt rescheduling becomes more and more difficult due to an increase in creditors not represented in the Paris Club. The current crisis has already seen a number of bankruptcies of companies that operate across borders, and their number is likely to increase. The absence of a formal mechanism for dealing with the impact of cross-border bankruptcy and insolvency, especially when related to financial institutions, transmits the adverse economic effects to the global economy.

A uniform approach to financial and investment disputes on bankruptcy and insolvency is especially important, given the fact that the regulations dealing with these matters included in bilateral free trade agreements often transcend existing multilateral treaties and national legislation.

- **Completion of a truly development-oriented trade round**

There is a need for a genuine development round, resulting in the creation of an international trade regime that truly promotes growth in developing countries. It is essential that the long recognized principle of special and differential treatment of various kinds of developing countries be preserved in all trade negotiations.

- **More stable and sustainable development finance**

The imperativeness of larger and more stable sources of finance for development—including for the investments needed to address the long-run challenges of responding to climate change—and new institutions for the disbursement of funds has been discussed earlier.

Market-driven international capital flows are of a magnitude and volatility that can offset any formal mechanism to provide additional finance for development. Thus, the active management of foreign capital inflows will be required to ensure that they are supportive of government countercyclical policies. The IMF's Articles of Agreement provide members control over capital inflows and expressly exclude the use of IMF resources to meet imbalances resulting from capital account disequilibrium. The IMF should thus be encouraged to return to its first principles and support countries that attempt to manage external flows in support of domestic countercyclical policy.

The international system requires a variety of mechanisms of innovative finance, including regular emissions of new global reserves (SDRs), revenues generated from the auction of global natural resources (such as ocean fishing rights and pollution emission permits), and international taxes (such as a carbon tax, which would simultaneously help address problems of global warming, or a financial services tax, which would simultaneously help stabilize international financial markets).

The receipts could be directed to help underwrite costs to developing countries of reducing greenhouse gas emissions in the context of their national policies to promote sustainable development. The effective implementation of national systems of taxation form a crucial part of domestic development finance. Measures should be taken to preserve national autonomy in the selection of the sources and methods of government financing while ensuring that national differences do not create incentives to evade taxation. An efficient method of achieving this result would be the acceptance by all countries of an amendment of Article 26 of the United Nations Model Double Taxation Convention between developed and developing countries to make the exchange of information automatic.

The scope and boldness of this thinking and these recommendations stands in sharp contrast to the limited range of the recommendations emerging from G-20 meetings.

## What Has Happened since June 2009?

A three-day conference on the World Financial and Economic Crisis and its Impact on Development was convened from 24–26 June 2009. The lack of high-level attendance by the major powers and the absence major media attention was notable. In September, there was also debate on the economic and financial crisis during the sixty-fourth session of the General Assembly. Very briefly, this latter debate can be summed up as follows:

- Nearly all countries touched on the need for reform in the face of the multiple crises facing the world today, whether they couched this in terms of a new multilateralism, new global governance, UN reform, or a reformed global financial architecture.

- While Australia, Canada, and Russia focused on the importance of the G-20, countries such as Argentina, Brazil, France, South Africa, Sudan, and Zambia focused on the need to reform the Bretton Woods institutions. China and France emphasized the importance of these institutions, as well as the need for reform.

- Japan, Kenya, Mexico, the Netherlands, Russia, South Africa, South Korea, Sudan, Sweden, and Turkey all focused explicitly on the importance of the United Nations, including the need for reform of the world organization with an emphasis on revising the UN's role in global financial governance either implied or mentioned directly.

- France, India, Nicaragua, Russia, Sudan, and Venezuela were the only countries to directly refer to the Stiglitz Commission—all in a positive light, with Nicaragua and Venezuela dedicating the most time to it in their speeches.

Since then a deep silence has fallen over the Stiglitz Commission's suggestions. This discrete pushing aside of common sense proposals, especially those calling for reform, reminds us of the three UN reports written and presented around 1950 that proposed a global development framework (see Briefing Note number 10). No action was taken then, or now. Discussions take place in the G-20—a step in the right direction—but not far enough. The stock market has risen since March 2009, and the next bubble is on the horizon. But the real economies of many countries—both developed and developing alike—are very much in shambles. The unemployment rate in many countries remains high, and financial deficits are exorbitant.  The accumulated debt of certain states is preoccupying, to put it mildly, and so is the debt of individuals and companies. In many countries, the economic and financial situation has become unsustainable.

This crisis started in the United States and not in East Asia or Latin America. The United States therefore has a global responsibility, here as well as in other domains. Stiglitz in the first issue of the 2009 *International Labour Review* suggested that if the United States had taken the almost $800 billion stimulus package and created a new bank that would have used a 12-to-1 ratio (very modest leverage compared to what was done by the banks that were bailed out), the result would have been an $8.4 trillion increase in lending capacity to stimulate small business in the United States as well as elsewhere.

In terms of the "Three UNs" (see Briefing Note number 3), this is an interesting case. The discussion on the Great Recession started in the General Assembly (the first UN, the UN of governments), which created a commission of experts (the third UN) that was assisted by the UN Secretariat (the second UN). All three UNs were involved, and yet follow up remains elusive.

It is not the policy ideas that are in short supply, but the political will to take action. Also restraining serious reform is the determination of the major powers to keep discussion and decisions on policy in the forums where they dominate—the IMF, the World Bank, and the G-20. A greater willingness to listen to UN bodies and to take more seriously recommendations arising from them would do much to avoid the recurrence of economic and financial disaster and its human consequences.

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