THE BROOKINGS INSTITUTION

GLOBAL PERSPECTIVES ON THE U.S. FINANCIAL CRISIS

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Introduction:

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Featured Speaker:

THE HONORABLE WAYNE SWAN, MP
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P R O C E E D I N G S

MR. LINN: Good morning ladies and gentlemen. It's a great pleasure to se you all here today. My name is Johannes Linn and I am the Executive Director of the Wolfensohn Center for Development at Brookings.

It's a great pleasure to welcome you all on behalf of Strobe Talbott, the President of Brookings and Lael Brainard, the Vice President for Global Economy and Development. And a special welcome, of course, this morning to our keynote speaker the Honorable Wayne Swan, the Treasurer of the Commonwealth of Australia. And also thank and welcome to our special guest Jim Wolfensohn, the founder of the Wolfensohn Center for Development at Brookings. Thank you for joining us today.

Today's event is, of course, very timely but I have to tell you the topic shifted over the last sort of four weeks as we started talking to the Treasurer and his staff about the topic for discussion. In the beginning we thought the Treasurer wanted to address issues of energy and food security, global warming and other important long-term global issues and give us the perspective of how these issues look and possible solutions from the Australian angle.

Then as the U.S. crisis heated up, the topic shifted and the Treasurer told us he was willing and happy to talk about the global implications of the U.S. crisis. Now today I wouldn't be surprised if in fact all we will talk about is the global implications of a global crisis.

We'll start today with the Treasurer's presentation. He will be

introduced by Jim Wolfensohn and this will be followed by a brief Q&A. And then we will assemble our panel for a subsequent discussion of the issues both as addressed by the Treasurer, but also beyond with a particular focus on the implications for the rest of the world of what's happening, including I would expect for the five billion people who are not in the news right now, but are affected and will be affected particularly negatively by what we have seen.

So, without further ado, I'd like to invite Jim Wolfensohn to introduce the Treasurer. Thank you, Jim.

(Applause)

MR. WOLFENSOHN: Thank you very much Johannes.

I'd like you all to know that I have a special pleasure in introducing the Honorable Wayne Swan this morning, because I want particularly to ensure that I can go back to Australia if I need to. If the situation gets any worse and I'm hoping that he will restore my citizenship, Mr. Treasurer, so that I can go back to my farm.

We're very fortunate; I have one. Anybody like to join me, you can let me know afterwards.

Our guest this morning was elected with his party to government on the 24th of November last year, having previously been a Member of Parliament from 1993 to '96 and then again from '98 until the present time. He is a graduate of the University of Queensland and before that had a period as a lecturer at that institute.

I have a lot that I would like to talk to you about, but in view of the economic situation I shall really cede to the Treasurer, but I cannot but read the introduction he wrote of himself in MySpace to describe exactly what the Treasurer is like.

He said, "I enjoy a good book, my back deck and a beer. A great curry, cricket with my son Mattie, music, cherry ripes." That's a confectionary in Australia. "Chatting with people in my electorate on the street, in the local pubs. Fetes and other community events. I like to get out and support the local Brisbane music scene, mainly because my kids are into it. But also because I am, a big fan of homegrown Aussie rock and roll."

Well, I hope that gives you a serious introduction to the Treasurer and I'm very honored to introduce him.

(Applause)

THE HONORABLE SWAN: Well, thank you very much Jim. Can I say you're welcome home anytime and if you want to come and see the Brisbane music scene you will be most welcome.

Could I thank Brookings for putting this on this morning. It certainly is a great pleasure to be here and it certainly is a pleasure to be here with so many distinguished panelists. And I guess there couldn't be a more important time or more important issues on the agenda than the ones I want to discuss today, which is really looking at the architecture of the financial system and where we are heading.

And of course, being here at Brookings to talk about this says something about the importance of the Brookings Institution because for us in Australia the work that you do at Brookings is one of those great global public goods that the United States produces. It provides some of the best policy advice in the world and it is a very successful organization. And I certainly, and many people that I move and mix with, do follow the work of Brookings very closely and of course we do send some of smartest young people here. We've got Michael Fullilove here today and of course, there is the great work that Jim and his

foundation engage in with Brookings.

James, of course, is a prominent intellectual elder statesman and a very good friend of the United States but still a true citizen of Australia.

Now Brookings for us is a think tank model, it's one that we really aspire to have in Australia. When I talk to people who are thinking about creating think tanks in Australia, they always point to the Brookings example. And why I say that is that great think tanks are very important, because what I think the world needs today, particularly in the grip of financial uncertainty is hard and serious thinking from hard-headed, warmhearted, and serious-minded people and that is of course what we have here at Brookings.

And, of course, in responding to current events our response must be coherent, it must address the underlying causes of our problems, and it must do so on a scale necessary to succeed in reducing the threats that we face. And, of course, our response must always be consistent with our values.

Governments and policymakers like us must seek greater levels of international cooperation to address these global challenges. This is very important. We've done it before and of course, we have done it in far worse circumstances.

In 1945, millions of men like my father came back from the Second World War to rebuild a conflict-ravaged world. That involved hard work and it involved a lot of sacrifice. And within a few decades they were able to create a level of prosperity their parents could scarcely imagine during the depths of the great depression.

But they wouldn't have succeed without other things. Especially the creation of new international economic frameworks, such as the Bretton Woods framework in July 1944 by giving the world the International Bank of

Reconstruction and Development, the International Monetary Fund, and what would later become the General Agreement of Trade and Tariffs. Bretton Woods provided the environment for free trade and financial stability necessary for prosperity. It was a great moral achievement as well as a great economic achievement.

Now thankfully this isn't 1944, nor is it 1929, and nor should it become so. But in broad terms the solution now and then is the same; the application of intelligence, common sense, and democratic values to produce an international consensus for cooperation and change. That's what we need now. It's critical that we foster reforms to the international financial architecture, which reflect evolving economic and political realities. And it's critical we ensure the necessary political momentum for collective action. That is perhaps the most important thing: political momentum for collective action.

So this morning I want to give you an Australian perspective on the crisis and outline some plans that I believe will help us come out of this crisis with a stronger global economic architecture. As all of you here will be aware, you'll all be aware of the chronology of unfolding turmoil in U.S. financial markets over the past year. This is a crisis that has so far claimed the scalps of more than 25 financial institutions around the world, and of course, it's seen borrowing costs rise right around the would.

This crisis has contributed to a serious global slowdown, which has seen output in five of the world's seven largest developed economics either contract or go flat in the three months to June this year. Now the Australian government most certainly welcomes the decisive action taken by U.S. lawmakers to deal with bad debts that continue to weigh on the U.S. financial system. But there will be further twists and turns to come. And there will certainly

be difficult times ahead.

That's why in Australia we've been building on our strengths and also why we are working internationally to address the consequences of this turmoil and put in place the architecture to avoid the next such event. That's what we must do.

Now the fundamentals in Australia are strong, but Australia is not immune from these global developments. Not immune at all. So our share market has fallen, our borrowing costs have risen, and consumer confidence is down. And this is having an impact on economic growth in Australia, but I am proud to say that Australia is better placed than almost any other developed country to withstand the fallout.

Just this morning in Europe the OECD released its 2008 Economic Survey of Australia and I want to quote what they had to say. "The economy has stood up well to the ongoing global financial market turbulence. So far the financial sector has withstood the crisis thanks to prudent management, high profitability, and strong capitalization."

Now this is a strong endorsement of the Australian economy and one that certainly accords with the IMF assessment, which was released about three weeks ago. Now the OECD also endorses the Rudd government's ambitious reform agenda, which is aimed at lifting productivity and addressing climate change. And there, of course, are topics for another day but nevertheless, very important ones. Very important to long-term economic prosperity to address all of these things and to address them for the long term, not the short term.

We are going through a comprehensive review of our tax system. We are looking a renewed investment in our physical and human capital. And of course, we are looking at the introduction of an emissions trading scheme. And

we certainly do welcome the OECD's support for our reforms and the acknowledgement of the benefits that those reforms will bring. Of course, the OECD is right to point to the strong, underlying fundamentals in the Australian economy.

We do have one of the strongest financial sectors in the world and also the fourth biggest, by funds, under management. While just 12 of the world's top 100 banks have AA ratings or above, four of the 12 that have the AA ratings are Australian banks. The deal of broker investment banking model which dominated Wall Street in recent years has not been as significant in Australia. We did not extend mortgage loans to subprime borrowers in the way the U.S. did. While the subprime market accounted for about 15 percent of outstanding U.S. mortgages, the equivalent number is just one percent.

The Australian government finances are strong with a projected surplus of nearly two percent of GDP. And we also find that the weight of global demand and production is moving our way; another strength in this environment. Our region now hosts three of the world's five largest economies.

China has become our largest trading partner and India our fastest growing export market. This is supporting our exports and encouraging historically high rates of business investment, another underlying strength of the Australian economy. So this does give us confidence. It does give us confidence that we can weather this storm and that is as I've said before a view shared by the OECD and the IMF.

Now while we understand Australia has many advantages, as I said before we are certainly are not immune. Even a strong economy like ours is buffeted by recent global developments. And that's why we are investing in our future productive capacity through education and infrastructure and other reforms

to lift our long-term growth potential. It's important to continue with these reforms precisely because they strengthen our hand in times of uncertainty. And we are also strengthening our strong financial regulatory framework.

But I do want to spend some time talking about what we have done to strengthen our financial arrangements. At a time when a debate seems to be gathering pace around the world about the re-regulation of financial markets, I think the Australian experience does have something to offer.

Can I say there is no mistaking the passion that motivates recent calls for re-regulation? Entirely understandable. How can any responsible leader observe all of the wreckage of this latest bout of financial adventurism without being stirred to act?

I understand the passion, yes I do. But I also know it's time to act, time to act with deliberation and time to act with foresight. It's a time to observe the lessons of successful regulation.

Now let me start by saying that we are not complacent in Australia about our arrangements. We know that in times like these, even the best systems can and do come under pressure. But our record of avoiding substantial subprime exposure, both at home and abroad, does offer a very interesting reference point especially when you consider our status as a fast growing developed economy with a strong record of competition and also a strong record of deregulation and deregulation in the financial sector.

Over the past 25 years Australia has done a lot to liberalize the financial sector, but in doing so we were very careful to develop a model that regulated systemically important institutions. This is critical. Regulated systemically important institutions and that centralized regulation of deposit taking institutions. And in doing so we ensured clear responsibilities, very clear

responsibilities within our system. And this meant we were better placed than most to respond to this crisis when it emerged.

Along with the Federal Reserve, our Central Bank stood ready to provide liquidity to the banking system as required and to extend the range of acceptable collateral. But more importantly, our system was robust because of what we did prior to the crisis. The reforms we put in place some time ago. Our banking regulator, the Australian Prudential Regulation Authority, was scrupulous in stress testing our financial system and ensuring adequate safeguards long before the global crisis began.

We also invited the IMF to do further stress testing and we were quick to adopt world's best practice. This helped ensure we did not indulge in the recent excesses and risk taking that has marked recent years in global financial markets, this in part because we have learned the lessons of past crises and periods where our banking sector was not so robust. When you are in a globally integrated economy that is very dependent a stable financial sector, you cannot afford to miss such lessons.

The Australian government is acting swiftly and decisively in response to this turmoil. We are implementing the Financial Stability Forum's recommendations in full and encouraging their implementation internationally.

We have taken steps to support liquidity in the government bond market to ensure our broader financial markets operate more effectively and more efficiently. We are strengthening protections for deposit holders through the introduction of a financial claims scheme. And we have moved with other countries to crack down on abuses of short selling.

We have taken steps to significantly improve the disclosure requirements for banks through the implementation of Basil II capital framework

in January this year. And to support competition in mortgage lending, the Australian government will invest an initial $4 billion in a domestic residential mortgage backed securities market.

But we also understand the very global nature of this turmoil and therefore the need for global solutions. The Australian Prime Minister and I have been in close contact with U.S., U.K., and European government leaders as well as those in our region with central bankers and with the heads of the major international agencies who have been grappling with this financial crisis.

Developments over recent days and weeks make this weekend's IMF and World Bank annual meetings much more important than normal. That is also why we are holding a meeting tomorrow of G-20 Finance Ministers and Central Bank Governors. These are the appropriate bodies for which we address the current crisis and strengthen the international financial architecture. My meetings with financial market participants in New York yesterday confirmed my view that substantial uncertainty remains and ongoing coordinated action is absolutely necessary.

Australia, like every other nation, will be in a safe position if international cooperation can improve global regulation. Now there are, of course, two extremes in this debate. Blind faith in markets is of course no substitute for being hard-headed. And blind faith in complete regulation all of the time is also no substitute for being hard-headed. The answer lies not in more or less regulation, but in better regulation.

It is important for all countries at this time, including the U.S., to debate the appropriateness of regulatory settings. And of course, we do welcome the debate initiated earlier this year by U.S. Treasury Secretary Paulson on his blueprint for regulatory arrangements. This debate needs to be

echoed in international forums. It’s crucial that existing mechanisms for cross-border cooperation and information flows can be fully utilized.

It is essential that market integrity is restored. Well-functioning, well-capitalized financial markets and sound corporate governance in this environment are absolutely critical. And it is imperative that we learn the lessons of the present crisis and transform those, transform those into action.

The International Financial Architecture which takes into account these lessons also needs to take into account the changing nature of the global economy and the changing nature of financial markets themselves. The problem here is that we failed to do this effectively in the aftermath of the financial crisis of the late 1990s. We did fail to do it then. On that occasion the major advanced economies correctly identified a need to improve domestic regulation and to strengthen global financial architecture. They undertook useful work on standards and codes and on implementing initiatives like the IMF-World Bank Financial Sector Assessments Program. That all happened.

The Financial Stability Forum, the G-20 were established with financial stability mandates; the G-20 in particular, brings together systemically important countries which make up 85 percent of global GDP. But the excellent work then and now of the Financial Stability Forum has sometimes lacked policy content and sometimes failed to get the political traction that it needs. That’s the problem. This is in part a reflection of its narrow membership which no longer adequately reflects the changing nature of the global economy and the financial system.

This is critical as we can’t afford to continue to repeat history. In 1998, a decade ago, the G-7 agreed and I quote, “To examine the scope for stronger prudential regulation in industrial countries, greater transparency in

disclosure for financial market participants, procedures to respond to financial crises, and the coordination of international bodies and international authorities." It sounds pretty familiar doesn't it? That was back in 1998.

So it's pretty clear that the world has not moved on enough. One of my officials working in a very senior role in the immediate aftermath of the Asian financial crisis once expressed his surprise to me that nobody wanted to talk about the crisis once it had ended. Well, much has been done to strengthen policy in institutional settings in emerging markets. There was too little interest in advanced economies in addressing the root causes of that crisis. And the lessons from that period now have to be learned so that we can move on with the essential reforms that are required.

So instead of being diligently addressed then, the key issues were placed in the too hard basket for another decade, another decade of inaction. The breadth and scope of the recent FSF recommendations is testament to the failure not to identify, but to fully act upon the lessons of the Asian financial crisis. And of course, this is why Australia has been pushing in international forums for FSF recommendations to be implemented widely and to fully ensure the regulatory balance and incentives are right.

Domestic regulatory reforms in major markets and better cross-border coordination between national authorities are the bedrock of the future. We have to act on crisis protection, prevention, and mitigation. And that's why we have been pushing in these forums for a strengthening of the global architecture for crisis prevention.

There is a key role for global institutions in detecting and responding to global problems. Relevant institutions must be able to identify and fulfill mandates that we have given them. To identify and respond to threats to global

financial stability, in particular through an improved early warning capability. And as part of this, key emerging market economies, some of which are major lenders must have a voice in renewing the architecture and in devising crisis prevention measures. They must be involved. The globalization of financial markets means that all systemically important countries are potentially part of the problem and they must be part of the solution.

Most recently our Prime Minister in a speech to the U.N. General Assembly on the 25th of September elaborated a reform agenda to provide a real political mandate for international institutions to do their job. The G-20 with its unique membership of systemically important countries and with financial stability placed at the center of its work program would provide political authority to have this agenda implemented urgently and comprehensively. The G-20 is the body to deal with these issues.

It's only through integrating this work into that of the IMF and driving it through the G-20 that we can bring real political authority to financial stability issues. It's very important that this is understood by all participants in this debate. Only a sufficiently representative body like the G-20, with the potential to respond flexibly to emerging challenges, can bring about reform of the global financial system that is so clearly needed. At times of great uncertainty there will always be the temptation, always be the temptation to create new forums.

Our energies should now be directed squarely at addressing the crisis and strengthening the global financial architecture through the existing forums of the IMF, the FSF, and the G-20. The G-20 would have a role in driving adoption of FSF recommendations along with five additional measures that the Prime Minister outlined recently at the U.N.

Firstly, all systemically important financial institutions would be

regulated in similar ways, subject to full disclosure and end analysis of on and off balance sheet exposures. This would be part of globally agreed best practice standards of financial regulation, which would be assessed by the IMF.

Central banks in each country would have responsibility for financial system stability. Secondly, banks and others would be required to build up capital in good times as a buffer for bad times using predictable rules. Capital requirements would in other words vary across the credit cycle. Leverage would be counter-cyclical, rather than pro-cyclical. This goes further than the current FSF recommendation that supervisors asses the cyclical nature of the Basil II framework and take additional measures as appropriate.

Thirdly, there will be high capital requirements for firms that reward short term returns or excessive risk taking in their compensation packages. This is very important, to get rid of the short-term focus and put some responsibility into the system long term, a responsibility that average people are yearning for from the financial system. And fourthly, supervisory systems will be compatible with accounting principles that reflect reasonable assessments of the value of assets over time so that accounting rules do not enforce pro-cyclical valuation changes.

And finally, under the Australian government's proposed reform agenda, the G-20 would also strengthen its input into shaping the work of the IMF and the FSF and the implementation of their great outcomes. And the IMF would have a stronger mandate for provincial analysis. And the IMF and the FSF would develop early-warning systems of impending institutional vulnerabilities and provide timely advice on remedial policies, which has the necessary political authority. The G-20 would itself engage on the risks facing global system based on regular scenario analysis provided by the IMF and the

FSF. This analysis would be included in an enhanced version of the IMF's global financial stability report. In addition, individual G-20 members would provide the IMF and the FSF with better information on the stability of their domestic financial systems and cross-border exposures. This plan will need to find wide acceptance among systemically important countries if it is to be implemented, but it does deserve acceptance. It's in the tradition of Australia's regulatory arrangements that I mentioned earlier, avoiding a heavy regulatory hand, but ensuring the right protections are in place. And I certainly will be advocating these ideas at the IMF and the G-20 meetings this weekend where the Fund will also be reporting on its own efforts to strengthen its analysis and policy advice on financial issues, its collaboration with bodies such as the FSF and BIS, and its ability to identify risks in the future. We simply cannot afford to repeat the mistakes of the past; to ignore the lessons of the last eighteen months and put aside hard decisions when conditions improve; and, in a far broader historical sense, to ignore the positive lessons of post-war financial history. As I said earlier, we strongly support the U.S.'s recent emergency measures. The world is now looking to the U.S. to show leadership on regulatory reform, and where the world is also looking to all of the systemically important countries to implement the FSF's recommendations and to take a critical look at the global financial architecture. These steps are at the heart of future crisis prevention.

All of these events are a loud wakeup call to the world. They must strengthen our collective resolve to agree and implement necessary changes because the current turmoil in financial markets is a pressing global issue. Real safety for everyone lies in what we have learned to do after the Second World War and what we forgot to do after the Asian financial crisis of the late 1990s: to

cooperate globally, to reach agreement on plans, and then to act decisively. It also lies in ensuring there is a longer-term view rather than short-termism that just one week ago Kevin Rod described as a virus, a disease, an epidemic, that lies at the core of this crisis and threatens the future of the globe. Australia wants to develop with the global economic community a coordinated approach to these issues that delivers a long-tern solution, not just a short-term quick fix. That's why we want a leadership role for the G20, informed by the work of the financial stability forum, enhanced by some of Australia's own ideas to improve bank licensing, liquidity, lending, and accounting supervision. It's up to us, the world's finance ministers, policymakers, and economists, to lead the way to agree on a coordinated response, and to show that we have it in us to fix this crisis and move beyond it with confidence to the ultimate benefit of all of those we represent. Thank you.

MR. LINN: Thank you very much. It's a great pleasure to have listened to this very thorough and insightful and thoughtful presentation. I think the notion that it's not just the crisis response we have now, but the lessons learned that will come out of this crisis being critical is the key point that I take away.

It's now my pleasure to hand off to Homi Kharas, senior fellow at the Wolfensohn Center, who will manage a very brief Q&A session that we have because the Treasurer and Mr. Wolfensohn have to run shortly to other important engagements. So let me hand off to Homi.

MR. KHARAS: Thank you. Well, to the Treasurer, thank you for a really quite inspiring speech. I think in an environment where everybody is extremely pessimistic and people are talking about carnage in the markets, it's really useful to have a statement with a lot of specifics about not only what

Australia has done, but also views about how those experiences can be taken to fix the global system. So I thank you for that.

Now as we get into the Q&A, I thought maybe we could start with the point that you made about the role of the G-20 driving the political consensus through the IMF. I think that's a very interesting observation, and I was wondering if you wanted to comment a little bit further on the mood, especially in Asia, of members of the G-20 in terms of whether they are prepared to unify, take this body, make it into what some have called a global steering group? Our colleagues in Brookings, Colin Bradford and Johannes Linn, have been hammering this point that the world needs a global steering group. I hear you saying that the G-20 could be such a group, and that it could then implement its recommendations through the IMF. But in Asia, the IMF has been absent for the last several years, since the financial crisis.

MR. SWAN: Well, firstly, the G-20 is the appropriate body. The G-7 simply doesn't represent all of the systemically important economies in the world, and of course, it excludes the whole of Asia, minus Japan. So it's critical that we have a broader group of countries involved in coordinating and responding. As I've moved around the world and spoken to finance ministers in developed and developing countries, and in particular in Asia, there's a very strong desire to see that they are represented at the table, not necessarily individual countries. It is the case that you do want and need a smaller body, but the G-20 I think picks up about 85 percent, and it picks up developed and developing countries, and of course, it gives Asia collectively a bigger seat at the table. And when you consider what is going on in the global economic system and how the weight of economic development is moving to Asia and to the Asian Pacific, it is just incredible that we don't have a body which is representative of that part of the globe. So the case for

a G-20 involvement here I think is just not arguable. But there does seem to be some resistance in the G-7, and we in Australia through the Prime Minister and myself and other ministers have been very active as we've moved around the world this year, seeking support from countries for a bigger role for the G-20. It's currently headed by Brazil as you know, and next year it will be headed by the U.K. It's a great time to really engage the G-20. And I think there's a fair bit of sympathy for that argument even in the United States. For now I'd also like to take the opportunity because there is a lot of criticism of what has occurred here, but from our perspective in Australia, we are very appreciative with the response of the U.S. authorities in terms of what's going on domestically, and it's a very difficult situation. But what we all need to appreciate is that it is a situation that spread rapidly around the world, and we're doing now a coordinated global response. And our government thinks the best way to do that is the G-20 working with an organization like the IMF to strengthen financial stability for all.

MR. KHARAS: Thank you. Well, our time is short, so I'm going to now open it up to the audience. I wonder first perhaps we might give the press a few minutes for questions before the Treasurer has to leave because I think we will only have time for maybe a couple of questions. So this is being audio recorded. If you would give your name and institution as you raise your hand for questions please. Any members of the press? The floor is open to anyone else. The lady in the back.

MS. GRIESGRABER: Thank you, Homi. This is Jo Marie Griesgraber from New Rules for Global Finance. Thank you Minister. I have a double question. One is how are you going to have a developing country -- and I don't mean the systemically significant, how about the rest of the world that's systemically insignificant and that really gets hammered in these situations --

how are they present in the room to express their concerns? And secondly, I don't really understand what you intend for the IMF to do.

MR. SWAN: Well, first of all, they are all represented at the IMF. But as a matter of having a decision-making body that is small enough to be effective, it's just trying to find the balance. I don't think our country, for example, would be in our deliberations ignoring those economies that you've described as systemically insignificant. And we have very much a commitment to working internationally to lift all countries, and we've made that a very clear part of our international program. So they're not being left behind; they sit at the IMF, but they wouldn't necessarily be sitting at the G-20. But there are plenty of people at the G-20 which will reflect their views -- it's much wider, much, much wider, than the G-7.

I think the IMF's got a really important role to play in terms of analysis. It is uniquely placed in terms of analysis. It's uniquely placed to develop early-warning systems. Its technical work is generally pretty good. It can certainly be further strengthened. I think the IMF would be a body which would further its current work in terms of assessment of economies around the world and so on, and be a source of information to a decision-making body. And I think that's the role that the IMF can play, and I'm sure after I talk with Mr. Strauss-Khan later on in the day, I'll be more further informed of that. He has ambitious plans for strengthening the IMF in the future, and that will be a good thing, too. I see the G-20 as being a body that can bring all of the information together and ensure the political action actually implements the policy. I see the IMF being very important in terms of policy development and in terms of supervision.

MR. KHARAS: Question in the back?

MR. COLORINA: Thank you. Rob Colorina, American Industrial

Acquisition Corporation. In situations where governments take equity positions in both the structuring, but then potentially in the upside, how do you manage exits where if the economies do pick up, there's in fact a fair exit and you don't hold too long?

MR. SWAN: I'm sorry; I actually missed the beginning of the question.

MR. COLORINA: This may apply a little bit more towards some of the U.S. economy situations, but when governments are taking equity positions.

MR. SWAN: Well, I think we're returning to a world where governments will continue with a nationalized banking system if that's what you're suggesting. I mean, the initiatives that are coming through in Britain are a stability measure. But I think what we do have to talk about is what are the benchmarks in this new situation if this is to be the primary measure by which governments move to stabilize their banking systems in this situation? What are the procedures that governments subsequently use when conditions normalize? And that is precisely the area where a body like the G-20, working through the IMF, providing a sort of analytical work would be quite important. This is uncharted territory. You know, if you would have said to anyone fourteen months ago that 25 very important financial institutions would keel over in the space of a few months, that governments dedicated to free enterprise suddenly turned into rampant nationalizers, people would have thought you were reading some sort of fictional novel. But we are in extraordinary times, which require action, and effective action. And I think it's very important that the ideology doesn't drive those actions, but actually should drive the practical desire to stabilize the system. I think one of the reasons we're in this bind that we're in at

the moment is there's been a lot of ideologies substituted as policy. And so much of that ideological debate is prejudiced to debate about what sort of effective regulation we need. I think it's pretty clear to everybody as a result of coming out of this crisis is the mantra of deregulation as an end in itself is sterile, equally overregulation is a dead hand that will starve for growth. That judicious mix that you need in a mixed economy is what we ought to be striving for here. And the point I was making in my comments is that to some extent, I think in our country we've gone some way towards finding that judicious mix.

MR. KHARAS: We'll take one final question.

QUESTIONER: Sir, no matter how much they tell us that the problem is that the market lent money to borrowers with poor or patchy credits, that is not the truth. The market at large bought securities collateralized by credits from poor and patchy borrowers with AAA ratings. And that stands at the core of this systemic fault of the whole system right now. Some of us are extremely worried when now central banks are starting to talk about taking up the role of credit rating agencies, just doing a better job of it. What is your view on that?

MR. SWAN: Well, part of the solution here does lie in the reform of credit rating agencies. This is just one of the monumental failures that is part and parcel of the problem that we are dealing with. And in our country we are currently undertaking a review of the activity of credit rating agencies and evaluating all the options as we move forward with further reforms to strengthen the system. But even before you get to the credit rating agencies, you've got to say what sort of regulatory system could have allowed subprime loans to become 15 percent of home mortgages in this country? Now it didn't happen in our country thankfully. The level of loans of that nature are a bit less than 1 percent, but first thing is a fundamental failure of regulation, and then a subsequent failure of supervision in

all its forms, and that includes the credit rating agencies.

MR. KHARAS: Treasurer, thank you very, very much. We have a panel session now where we'll continue the discussion and ask our panel about the impact of this crisis on developing countries. So I'd like to ask our panel members to come up please. There are seats in the front for those of you who are still standing at the back. So let's get started.

We have a terrific panel. We're going to be trying to broaden this discussion now as I said to beyond just the implications for global financial architecture, and talk more specifically about what this means for developing countries, what this means for the five billion people that I think Johannes said were not represented perhaps in the G-20 forum of systemically important countries.

So our panelists are first on my right, Brad Setser. Brad is from the Council on Foreign Relations. He's done a tremendous amount of work on sovereign wealth funds. He is an expert on the global architecture. You have the CVs I believe in front of you, so I won't try to go into everybody's qualifications. I assure you that they are terrific. On my right is Eswar Prasad. Eswar is a professor at Cornell and also a Senior Fellow here at Brookings in Global Economy and Development. He has written widely on developing countries. He's also a specialist on India and India's financial economic reforms. And just in time, Mauricio Cárdenas on my left. Mauricio has come to Brookings to head a Latin America initiative. So I think here on this panel we've got a group that has experience in pretty much across the world.

Now before we get to the panel discussion, I would like to make one small announcement; that in this whole environment of thinking about well, what is going on? Will it be a 10 point decline in stock markets? Will it be a 10 point

increase in stock markets the next day? There's also a sense that there are long-term issues which are pressing for the world. And whoever comes in the next administration I think is going to have to address this combination of a short-term -- potentially a short-term -- catastrophe and do it in a way that also contributes to the long-term effects. And that long-term effect is something that - will have different implications in different regions of the world. Global Economy has just come out with a volume. It's called "The Top Ten Challenges." It is outside. I hope you picked up a copy as you registered to come in. If you didn't, there will be copies available as you go out. It's a terrific volume, and it, as the name suggests, puts down on paper some of the top ten challenges that any new administration will have to deal with. And as you go through that volume, what you'll see is that these challenges differ from region to region. And we're very excited at Brookings to now have much more of a regional focus in what is being done. So Mauricio has come now. He's director of the Latin America Initiative in Brookings. As I mentioned, Eswar is doing work on India. We have the Thornton Center at Brookings, which is focused on work on China. And we have just launched a new Africa initiative as well, and we're building up that program. And then in the Wolfensohn Center, we also have a program on Middle East youth and there is a paper there. And Navtej Dhillon sitting in the audience is the director of that initiative. So I think it's very important to make sure that we have a clear understanding of the different consequences and implications of this crisis and other long-term issues for different regions in the world.

Now, back to our panel discussion. And I'd like to start -- I'm going to go in this order -- I'll start this with a couple of questions for each of the panelists, and then we'll open it up to a Q&A.

So Brad, if I can start with you. You know, we've heard a lot about all

of the various measures that people are proposing in order to fix the financial sector, and we've heard about governments putting in capital increases into banks, and buybacks of bad assets, and deposit insurance being guaranteed, et cetera. But you've really written a lot on the real economy imbalances in the world, and especially about the role that undervalued exchange rates in Asia have played in contributing to these real economy imbalances. And that discussion seems to have fallen off the table. There isn't really any, you know, major talk about that. So do you think that by ignoring that, we're really dealing with symptoms of the problem and not the root cause?

MR. SETSER: Yes and no. I mean, I think all the discussion that we heard earlier today suggests that the freezing up of the U.S. financial sector will quickly translate into a very meaningful fall in consumption here in the U.S., a meaningful slowdown in investment here in the U.S., which will have the effect of reducing some of the imbalances that have built up over time. So in that sense, I think even though there isn't an exact ongoing discussion about what to do about the imbalances, the fallout of the financial crisis will have that effect. Moreover, I think this is somewhat ironic -- I mean, this has been a financial crisis whose epicenter has been in the United States, but it actually hasn't been a dollar crisis. The dollar's appreciated quite significantly, which again, is rather ironic, and it means that there's been much more nominal and real appreciation of China's currency over the past three months than there was over the preceding three years. So in that sense, some of the broader imbalances, including the imbalance between China's currency and Europe, are being somewhat corrected. Probably not in an ideal way, but they are being corrected. If we could go back though, I think I would say that this is in some sense a crisis of this broader order where emerging economies finance the U.S. and Europe. It is a byproduct of a system

where Asia -- notably China -- and the oil exporters both were running larger current account surpluses than ever before at the same moment in time, which necessarily implied a large deficit elsewhere in the global economy, either in the U.S. or Europe, and much of that deficit was found in the household sector in the U.S. And I think little known is that an increasing share of it was found in the household sector in Europe as Europe went through its own version of a real estate boom over the past several years. Now the flow of funds was not one where the reserve accumulators in China directly financed subprime borrowers in the U.S. The flow of funds was much more one where -- let's just choose China as the largest, most representative of the many countries were buying treasuries and agency bonds, which, generally speaking, the agencies weren't doing the majority of the subprime lending; that was done through private mortgage-backed securities, which bought up a lot, even more so than through the agencies. But by doing so, they freed up funds inside the
U.S. that were intermediated through U.S. financial intermediaries to lend to ever-riskier borrowers, ever-riskier households. And what so much surprisingly to those like me were much more concerned that there might be an unwillingness on the part of central banks to keep adding to their dollar reserves and take the risk of financing the U.S. with this large deficit in dollars. Well, that more or less continued, that didn't trigger a crisis. What triggered a crisis was a collapse of the second stage in the process, the financial intermediation here in the U.S. So I'm not sure you can really differentiate and say that this is not a broader crisis of this overall global financial order premised on emerging-market governments intermediating their large surpluses, and then using the financial sectors of the U.S. and Europe to finance growing deficits in the household sector.

MR. KHARAS: Thanks. Eswar, here we have the IMF now

predicting that all of the developed countries are going to be headed into a recession early next year, if they're not already moving in that direction. You've argued in the past that there is convergence in business cycles among developed countries, and that part of your story seems to be vindicated by these IMF forecasts. But you've also then suggested that there is less convergence between developed countries and developing countries, that there is in fact some decoupling. Do you still think that there is significant decoupling, and do you think that growth in emerging economies is now going to save the world from a recession?

MR. PRASAD: Oh, that it were so. I think it's useful to begin by putting some more structure in the question you asked of me because it is a very important question. It's a strange world we live in where the Chinas and Indias of the world are expected to be the saviors of the U.S., but certainly something important that has changed in the world of economic order. It's also useful to separate out these two concepts of real decoupling versus financial decoupling, and I think this is important in terms of structure in the discussion.

In terms of the question that you specifically asked about what the effect of a U.S. financial crisis and its effects on other industrial economies are likely to have on the developing economies, there are of course three or four channels one can think of. One is the traditional channel to the real linkages -- and clearly there's going to be a very significant effect on many emerging market economies that are either export oriented because after all, it's fairly clear that much of the final demand on most industrial countries is going to slow down considerably in terms of the growth rate. But the financial linkages, of course, are the more interesting ones right now. And here again there are two or three ways of looking at it. The traditional concern used to be that if there was a financial crisis in

the U.S. or other advanced economies, you would have capital no longer going to the developing economies that needed it. Now as Brad pointed out, the world has changed in one very fundamental way. You used to have net private capital flowing to the developing economies; last year it was about half a trillion dollars of net private capital flows. But if you look at the overall capital flows, it's been from the developing countries to the industrial countries. So you had about a trillion dollars worth of overall flows going from the developing countries to finance the rich country current account deficit system Brad was talking about. So the traditional concern that an emerging market might have about the sudden stop or the reversal of capital flows doesn't seem to be in the cards. Given the nature of capital flows, and given also the fact that the way these capital flows have been going and current account surpluses have been going, many of these emerging-market economies have of course built up very large arsenals of reserves. But these private capital flows do have a significant marginal effect still. A lot of them are equity flows going into liquidity markets in some of these countries, and we've already seen in countries like India, which are very open to portfolio equity inflows, there seems to be a very significant marginal effect of a pull-out by foreign investors on Indian equity markets. So I think that effect will persist.

Similarly one would have a contagion effect of pure concern about equities and so on, not just through the financing channel from abroad, but also concerns about these spillover effects that are becoming increasingly obvious in the data. And this I think is very clear, that there is very strong financial coupling taking place. But in terms of the translation to the real economy then, there are subtleties in terms of thinking about different emerging-market economies. In the U.S., finance is an inextricable part of the economy. In emerging-market

economies, finance is important, becoming increasingly important, but it's still not important enough to, in a sense, bring down real activity to its knees. If you think about China, for instance, the banking system isn't really very important. But at this state-dominated banking system and with the reserves of the Chinese Central Bank, it's unlikely the banking system will get into a lot trouble. The stock market has declined in recent years, but it's not as important to the Chinese economy as the U.S. stock market is to the U.S. economy. So my feeling is that there is going to be a significant problem in terms of the financial channel, but it's not going to be as large as in the Western economies. The other channel, of course, is the fact that you do have many of these emerging-market economies having opened up more to foreign banks and foreign financial institutions, so, of course, there will be an effect through the limited operations of those firms in the emerging-market economies and the tie-ins that domestic banks have to foreign banks. In India, for instance, there was a big concern about the fact that many local financial institutions had contracts with Lehman Brothers, which had to be unwound very quickly. But, of course, the Bank of India stepped in and took care of it in a fairly quick way.

The biggest concern I have to be honest is about the confidence effects, and we've already seen some minor panics double up in some countries like India. The notion being that if these big gargantuan Western financial institutions can fail, and given the frailties that exist in the emerging-market financial institutions, there is concern now that even if there is implicit government backing, whether things could go down the hole. So I think it's a little early to tell how large the effects are going to be, but again, we're thinking about a slowdown at this stage in emerging markets, which I think is going to be inevitable at this stage given how large the shock to the world system is. But I think we're very far

from a significant meltdown yet.

MR. KHARAS: Thanks. Well, Mauricio, Latin America again seems to be the region which is one of the most seriously affected in terms of growth, certainly if you look at the fund projections. Asia seems to be holding up reasonable well. This is after, you know, more than a decade of reforms in Latin America. What do you see as the prospects for Latin America and the main transmission mechanisms from this crisis to the real economies' downsize?

MR. CÁRDENAS: Okay, thank you, Homi. I'm delighted to be on this panel. Well, Latin America is doing relatively well given the magnitude of the financial crisis. The world economic outlook that was released last Wednesday basically forecasts a growth rate for this year for the region as a whole of 4.5 percent. We have declined for next year to 3.5, so it's hard to say with those figures if there'll be a recession. I think it's essentially a deceleration. Some countries will do a lot better than others. For instance, Brazil will continue to grow. This year the forecast has actually moved up to 5 percent. So what this says is that there has been contagion. There is no doubt about that. But that the contagion hasn't really had a major impact on the real economy. We've seen contagion in financial markets, the stock prices in the main Latin American markets declined last month by about 20 percent. Their currency has depreciated also by a similar amount. We've seen an increase in the spreads between 150 to 200 basis points for the major countries, except Chile. Spreads for Chile have gone up only about 90 basis points -- so there is an effect. But I think to the extent that commodity prices remain high -- they've been declining, about 10, 15 percent last month, but they're much higher than their trend level. And as long as that continues to be the case -- and I think that depends significantly on what happens to China -- Latin America being a primarily

commodity exporter -- about 50 percent of exports in Latin America are still commodities -- will continue to be in relatively good shape. So we're going to see for the first time in many years a crisis originating in the developed world that will have an impact in the region. Certainly some countries will suffer more, Mexico and Central American being a case of larger impacts, but the region as a whole is a lot more resilient, and why is that the case? I think what makes a big difference now compared to ten years ago is that Latin America does not have, as a whole, a current account deficit. Latin America has much lower inflation rates, single-digit inflation rates in most cases except Venezuela and Argentina, which are really outliers, so the fiscal situation is also much better. That means that there is less dependence on capital flows to the financial structure, and that means that there is a situation where if financial markets dry up somewhat, the real consequences of that are not going to be that significant. The region will not continue to accumulate foreign reserves in the magnitude it has saved. Foreign investment flows will be somewhat reduced, but that does not result in a major deceleration or a recession that was mentioned before.

MR. KHARAS: Brad, let's turn back to you. And I'd like to move the discussion now a little bit to liquidity. Liquidity in this environment is obviously king, and Asian countries have an awful lot of liquidity. They've got that liquidity because they've spent years building up mammoth foreign exchange reserves. Everybody said that this was a terrible problem. Look at it now from their point of view, do you think that this validates the Asian policy of building up reserves? Do you see that these reserves will now be used to move in, perhaps to buy up assets in the U.S. and Europe on the cheap? And the process that the Treasurer mentioned of global economic weight shifting to Asia will be somehow facilitated and accommodated by their ability to purchase these assets? And will that be a

good thing for the United States?

MR. SETSER: One lesson that all emerging economies drew from the crisis of 1997 and 1998 was that they needed to hold more reserves. I'm sure that one lesson all countries will draw from the crisis of 2007 and 2008 is that they need to hold more reserves. Now if you look at, say, a country like South Korea, which thought it had plenty of reserves when it had $250 billion in reserves, and was considering putting some of those funds into a sovereign wealth fund, put a little bit of money into Merrill Lynch, was starting to invest those funds more aggressively to get higher returns, I think it now regrets having put the money into Merrill Lynch. I think it now regrets having invested in various complex structures to try to get an extra 20 basis points out of its reserves. And I think what it is now saying is well it may be that $250 billion is the right number, and previously we thought maybe we had too much, and we needed to make sure that all of that is liquid and available. So what you see -- if you watch reserve flows very, very closely -- is you see an enormous flight to the safest and most liquid reserve assets. You're seeing in some sense a panic among central banks who had taken any risk whatsoever. The best evidence of that is the New York Fed's custodial accounts. The latest data came out last night, and between September, I think, 10th and October 10th -- and I don't have the precise dates mentioned, but that four-week period -- central banks added over $100 billion to their Treasury portfolio at the New York Fed while reducing their agency portfolio by about $8 billion. But I think that 90 plus increase in Treasury holdings is only possible given the global slowdown in reserve growth. If there's been a shift away from deposits in banks, away from money market funds, so forth and so on, I think the first point then to make is that the overwhelming move by central banks over the past six months -- and I think to some degree, although the data is hard to find, by

sovereign wealth funds as well -- has been away from any kind of risk because their fundamental characteristic of sovereign money is a deep aversion to taking losses and a deep aversion to taking losses that the entire public in your home country knows about, which I think will be an enormous caution and limit on a sovereign's willingness to make significant investments in the U.S. Does this validate the policy of building up reserves? No. China has, even now, way more reserves than it needs. China is not Korea. China has ten times if not more reserves than Korea. And the process of building up those reserves, as I argued earlier, created or contributed to these imbalances that are being unwound. So yes, maybe you're more protected against the crisis, but if countries had allowed their currencies to appreciate and had not been financing the U.S. and Europe, there wouldn't be the kinds of crisis that leads to such a disruption in the global system that creates pressure for so many reserves. So my strong sense is a suboptimal outcome all around. I also personally suspect that the time when a friendly sovereign wealth fund was willing to come and recapitalize the U.S. financial system has kind of come and gone, with the possible exception of China, which may have a different agenda. Those sovereign wealth funds who came in claiming too early and lost money, lost money in a very visible way, and that is causing difficulties for them at home. Moreover, even in the big places in the Gulf, there are more pressures on the sovereign wealth funds now to do things to support your own home country. The Kuwaiti Fund has been buying up Kuwait stocks. Abu Dhabi is considering how it can backstop Dubai's banking system. So I think there is much more pressure to support your own country and your own country's banks in a global environment where there is overwhelming retreat from risk. And as a result, I think the U.S. is going to be in a situation -- may already be in, I don't know what the President has said -- where rather than relying on foreign

governments to recapitalize America's banks, the U.S. is going to be relying on the U.S. government to recapitalize the United States banks. And I think that's probably the best help.

MR. KHARAS: Thank you. Eswar, emerging-market banking systems haven't really taken and gone through the same kind of problems that we've seen in Europe and the United States. And some people credit that to the idea that financial liberalization just didn't go that far in emerging countries. In India, the Reserve Bank Governor -- ex-Reserve Bank Governor, Mr. Reddy, is now being talked up as a hero for his failure to do any kind of financial market reforms, including the ones that you advocate. So, you know, is this a general trend? Do you think that we're going to see much less financial sector liberalization now in emerging markets? And do you think that despite this current crisis, there still remain major reform elements in the financial sector that countries should be pursuing? How are we going to get over this kind of perception obstacle?

MR. PRASAD: Not surprisingly, the instinct of the average policymaker in emerging markets right now is to batten down the hatches, disappear into a deep hole, and stay there until everything blows over. But I think the time for that has past in some sense because many of these economies have become much more integrated into the international financial system, and it's not really an option for them anymore to reverse this process very easily. So then the question becomes how they move forward without exposing themselves to many risks? And although it is true that in the present financial crisis the emerging markets' financial systems have come through relatively unscathed, at least so far, there have been very significant welfare costs to the sort of approach that has been taken in many of these economies, and Brad has alluded to some of these

already. It's been held together in many of these economies, and one can pick China as a prime example. By a combination of policies in the external sector, capital controls over there, weaning themselves off it to some extent and the world is weaning them off it with capital increasingly making its way around the controls. But also a fixed interest rate and more importantly, a good deal of financial repression with the banking systems still being the major game in town with the rest of the financial system not being able to double up very easily with all these shackles put upon it. And this has implications not just for growth in the long term and sustainability, but the welfare that is derived from that growth. So if you think about China's standard responses or India for that matter, what do we care about the financial system if, in fact, they can achieve growth of 8 or 10 percent a year? Who ultimately cares? And who ultimately cares is a fair enough point, but it is true that if you look carefully at the composition of growth in these countries, it does lead to cause for concern. It's not generating very much employment growth. China's getting 10 percent GDP growth, barely about 2 percent employment growth, and this is why they are concerned about growth dropping to 6 to 7 percent, which in any normal times one might think is still a fantastic growth rate for an economy. But that might essentially drop employment rates down to zero, and they really need that to keep the economy going. But more importantly, there is this mantra of inclusive and sustainable growth that we've been hearing about and there is good reason. There is at least some truth to them. And the problem in the financial system in many of these economies is that they're just not working very well in terms of delivering financial services to a broad segment of the population. So even if one kept financial innovation aside for a moment, there is still a lot that needs to be done in the financial system in these economies. And there is a big irony here about the way things are going in the world, especially in

the last few weeks. On the one hand you have Comrade Paulson and Comrade Bernanke essentially taking over the financial system in the U.S., and shutting down short selling and putting a lot of constraints on markets. At the same time if you take what is happening in China and India, interestingly in the last few weeks, many of the main regulators have come up with statements that, in fact, even though there is this financial panic spreading around the world, it's even more reasoned by these countries' need to strengthen their financial systems. Now when they talk about strengthening their financial systems, of course they don't necessarily mean opening up to a great deal of financial innovation that they feel they cannot regulate. But still the financial systems in these countries are not working very well. An interesting example, for instance, is this question that was posed to the new Securities and Exchange Board of India Chairman, Mr. Bhave, about how he was going to respond to the U.S. shutting down short selling. And he made a very clear statement that he thought short selling was not the problem. There were enough safeguards in the system. And if there were problems, they were deeper in the system. And shutting down short selling would essentially shut down a very large part of the regulators markets, and he said I don't want to do that because that is not the real problem we're trying to solve. So I'm encouraged that at least there is recognition in these economies that financial system reform needs to move forward. Although I think there are very important lessons that the emerging-market economies are learning, but figuring out what the right lessons are is going to take some time, and I think we need to work our way through some elements of this crisis before we can take stock in a sensible manner.

MR. KHARAS: Thanks. Mauricio, Latin America seems to be in a particularly difficult situation because of its long history of problems with inflation. It's very difficult for many Latin American governments to pursue the policies of

reduced interest rates that we've seen in developed countries. And because of their history of debt crises, it's very difficult for a lot of Latin American governments to pursue the policies of expanded fiscal deficits. So if you take away those two instruments, are they sort of caught in a bit of a bind? What else can they actually do to respond to this?

MR. CÁRDENAS: Well, there is some room for policy, but I would tend to agree that first the policy package in the advanced economies has to work. And the policy package has been essentially increasing fiscal expenditures, a reduction in taxes to stimulate the economies, and reduction in interest rates as we saw this week. When the problem is a problem of credibility -- we're seeing that the markets are speaking for themselves -- the assets in which the markets believe now are the dollar, the U.S. Treasuries, and gold.

That means that it's not just providing liquidity, it's not just buying the toxic assets, at some point the problem of credibility will be solved only when these credible assets are involved, and the credible assets being the U.S. Treasury is engaged in equity and capitalizing these institutions. I think that will solve the problem, not just liquidity. So for Latin America, I guess the position for them in a majority of countries is to wait and see until these policies are effective. And also, as I said before, waiting and seeing what happens with growth in China, which is so important. However, there are some countries in the region, especially those ones that are potentially more affected, that have started to adopt some policies in reaction. Mexico yesterday announced a fiscal stimulus package of $5 billion, that's about 1 percent of Mexican GDP. And I think soon we're going to see a reduction in interest rates in some countries, particularly in Brazil and in Mexico. There are other countries because of what you just mentioned, Homi -- the inflationary pressures and a weak fiscal situation -- do not have, you know,

tremendous room to maneuver. That's the case of Chile. It's running on an inflation rate of 9 percent. It's very difficult to reduce interest rates in Chile today, same in Colombia, and certainly the same case in Argentina. In terms of the fiscal conditions, some countries in addition to Venezuela could also expand somewhat. They have the capacity. Peru and Chile or there's none. Brazil and Colombia are not in a position where they could really stimulate their economies with a fiscal expansion because they certainly risk a bad reaction from the markets in terms of a downgrade of their credit ratings or an increase in the spreads.

Now let me finish with a word on Central America. We don't speak too much about Central America, but Central America is trapped in a very difficult situation. It's a region within the Western Hemisphere that has not benefitted from an increase in commodity prices. They actually have lost in terms of trade, and at the same time they're closely linked to the U.S. economy through remittances, through trade. So they are suffering from these -- as Eswar was mentioning -- traditional trade channel effects, and at the same time they are in a very weak situation from a fiscal point of view, so most of these economies that cannot really react by expanding government expenditures or reducing taxes in order to stimulate their economies. So I think Central America is in a situation that would potentially be the region across the Western Hemisphere with more severe losses in terms of GDP growth and increases in unemployment.

MR. KHARAS: Thank you. Well, let's throw this discussion open a little bit. I mean I actually think this was a pretty sanguine panel. I mean Brad says global imbalances are going to disappear as the U.S. goes into recession so imports will collapse. Eswar says no risk of sudden stops and we've got sensible guys in India who aren't going to panic and stop short selling. Mauricio says that Latin America's doing just fine considering it's Latin America and not Asia. You

know, I didn't get any sense from our panel of doom and gloom for emerging markets. Anyone in the audience want to challenge them on this?

MR. PRASAD: You mean it just because they haven't seen markets today.

MR. KHARAS: But they all have. Antoine.

MR. VAN AGTMAEL: I had a question to the various panelists. Basically for years policymakers here preached to the Washington consensus and then proceeded to ignore it here, which caused the current mess we're in, in my analysis and very simple terms. And that's one reaction I get when I talk to people in various emerging markets. The other reaction I get is yes, we recognize that there has been no decoupling, that we are all in the same boat because everything is now collapsing. Now, out of that -- and I think it's going to be crucial this weekend -- comes a question about how we are going to fix this. And it seems at this point the only thing that can be done is a massive, coordinated intervention, not just by the old club of the G-7, but by a much broader club as the Australian Minister already said, what a G-14 or G-20, but a much broader club, which at the very least includes the major emerging markets. Now my question is this: If you take that as a premise, is there then a need for a large, new, multilateral institution, an institution that could be described either as a toxic waste disposal institution or a recapitalization institution, I don't -- I mean it has to be -- a good word has to be found for it. But the question is really clearly emerging markets want a seat at the table. This would be a way to give them a seat at the table because the old institutions resisted.

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