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MEMO TO THE PRESIDENT:

RESTORE GLOBAL FINANCIAL STABILITY

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P R O C E E D I N G S

MR. BLUSTEIN: Welcome to Brookings. My name is Paul Blustein. I'm Journalist in Residence in the Global Economy and Development Program here at Brookings. This event today is part of Brookings Presidential Transition Series for which scholars have written Memos to the President on key policy questions. Today our topic is global financial stability.

There is an understandable preoccupation with the domestic economic situation. For those of you who haven't seen it, our employment has come out at 7.2 percent this morning and obviously headed north rather than south unfortunately. But the new president has to deal not only with the domestic economic situation, because the global slowdown brings a lot of attendant risks for the U.S. It would be one thing if all we were concerned about was the situation in Iceland, but it's a lot more than that of course. All these countries where we hoped people would start spending like Americans suddenly have big problems of their own, China being the most prominent example. Eastern European countries, if they haven't gone belly-up already they're looking as if some of them might be about to. The situation in the rest of Europe looks pretty precarious, and of course Latin America as well.

Ten years ago we had a wake-up call about the sort of situation we're facing worldwide when we had the Asian financial crisis and a lot of people, and I count myself among them, thought that ought to have sent a signal that we ought to take some fairly drastic actions to prevent something bigger from happening in the future, but I think it's fair to say not a heck of a lot was done. Of course some individual countries did a lot to straighten out their internal policies to make themselves less vulnerable, but I think it's also fair to say that some of those measures have turned out to be a little less effective than they had thought, and internationally certainly in many ways the system became more unstable rather than less. So in Lenin's immortal words, "What is to be done," and what are the prospects for another round of reforms or proposals to actually be enacted.

We have with us Eswar Prasad, a Senior Fellow here at Brookings. He is also a professor of economics at Cornel, he spent 16 years at the International Monetary Fund, and he will present recommendations for what policy actions the Obama administration should take. Following that we will hear reactions from Barry Bosworth who is immediately on my right, and Colin Bradford down at the end, also both Senior Fellow here. The detailed bois of all three of these people are in the packets that are available outside. I can't resist mentioning one biographical aspect for Eswar because in the Global Economy and Development Program we internally get these little profiles sent around periodically so that we get to know each other and Eswar was the featured guy recently. One of the questions we were supposed to answer is what thing about you would other people find most surprising. I think Eswar takes the cake for the most surprising aspect of his bio which is that he speaks Polish. So without further ado, Eswar will now make his presentation, and either Barry or Colin is going to translate from the Polish. I'm not sure which.

MR. PRASAD: That's the reason my wife speaks Polish too. Thank you very much for coming.

These are very difficult and challenging times in the world economy and of course we have a huge change coming forth in Washington, D.C. and it's an important time for the U.S. economy as well as for the global economy. There was this notion that the center of world policies and economics was beginning to shift eastward, or westward I guess, depending on which way you like to travel, but there was this notion that the U.S. was becoming a little less important in the overall world economy. To a large extent of course that is true with many of the emerging-market economies coming into their own, but as the recent financial crisis has shown, the world has become substantially more interconnected through trade, financial, and human capital flows around the world in the last couple of decades and the U.S. still retains a very important position in the world economy. So I think getting economic policies right in the U.S. is essential not just for the U.S. but for the larger global economy and the prospects for the global economy depend to a significant extent on how things turn out in the U.S. again as we have seen recently where capitalism in the U.S. has had worldwide effects.

In terms of thinking about what role the U.S. should play, I'd like to structure my comments in two specific dimensions. One is thinking about the U.S. and its own macroeconomy financial and regulatory policies which I think have very large spillover effects on the world economy, and then to think more broadly about this notion of soft power, how the U.S. actually exercises its economic and political influence around the world. Here I am going to argue for a substantial change relative to what we have seen in the last 8 years where there was much more of a focus on unilateralism, and I think the world had come to some extent to resent the U.S. essentially telling the rest of the world what to do. But I think the U.S. still has a dominance that it can use very effectively and the opportunity is there if it can be grand. So let's think about the various dimensions that are related to what the U.S. in my view should be doing or what the new administration should be doing.

First of all, getting macroeconomic policies right in the U.S. I think is the critical challenge. Right now we are in the midst of a terrible crisis and Paul has already referred to some very bleak looking macro numbers, and even in the immediate future it does not look like there is any promise of the economy coming out of this slump. So the sort of stimulus packages we have been hearing from the Obama administration I think are the right ones. We need to go at this crisis on the short-run with all the ammunition we have. And we can of course have a discussion about how exactly to structure the stimulus package and so forth, but I think the U.S. administration so far is doing the right things in terms of using monetary policy and I hope fiscal policy soon relatively aggressively in terms of getting the system back on its feet.

Much of the stimulus of course is going to come from the fiscal side. With the financial system not working terribly well right now it's difficult to see monetary policies having a great effect. We have had very substantial cuts in interest rates, we do have very substantial ad hoc measures being taken to put the financial system back on its feet, and there is at least a glimmer of financial stability that we are beginning to see right now. But clearly, counting on the financial system and credit for the financial system to get the economy back on its feet is not the ideal thing for the short-run, so fiscal stimulus I think does have a very important role especially in the short-run. But of course given where the U.S. is in terms of its fiscal position and its debt position given what has happened over the last few years, the amount of room the U.S. has to expand its fiscal deficit is really very limited and sooner or later the piper is going to have to be paid, and there is a serious concern again about what the implications of current fiscal policy are for future generations and how we think about the rising burdens on fiscal policy in the future and especially the unfunded component of Social Security and a lot of other expenditures that are likely to come up in the medium-term. This is not the priority right now, but how the stimulus package is fashioned today and what implications it has for productivity growth in the medium-term I think will be crucial in terms of thinking about how to get the fiscal position back in shape in the future. One must again think about how the various elements that I have referred to in the memo are related because ultimately it was the U.S. position, both very low private savings and the public savings which are very low, essentially negative, that in a sense perpetuated global imbalances and may have had a lot to do with the crisis, and this is a theme I will refer back to later in the paper.

The second issue I think that is important and which we are grappling with right now is how to think about regulatory structures as we get out of the crisis, and here at least to my mind there are no clear answers. It is tempting to think about much greater regulation, much more effective regulation, and I think the lessons we are learning as we go through the crisis and I hope that we will come out of it reasonably soon, I think are going to take us a while to synthesize and there is the risk that a knee-jerk reaction toward much more comprehensive regulation could end up in fact giving us a false sense of security over the medium-term, and in fact if one goes back and thinks about the lessons learned, one might argue that in fact this very comprehensive regulation that we thought we had in the banking system and that it would be protected through a firewall from the rest of the financial system proved not to be true. Again, talking about interconnections, the entire financial system is so closely woven together that tightly regulating one part of the financial system while letting a Wild West sort of orientation prevail in the other part clearly does not work very well. But how one ultimately strikes a balance between government regulation and private monitoring is I think the key challenge that we need to think about and here again I would rather not try to get answers very quickly, but just framing the questions in the right way and thinking about a framework for thinking about this issue is ultimately the right approach.

One can of course dismiss the whole notion of private monitoring. After all, even the honorable Alan Greenspan has told us that private monitoring failed miserably. But thinking about why it failed in terms of what aspects of transparency, what aspects of regulation caused it to fail, I think are really important questions that we will need to deal with, but ultimately I think there has to be a role for private monitoring because the government simply cannot regulate everything as effectively as we could. It's not just a matter of regulatory capacity, but the financial system has such strong incentives to get around regulation that ultimately is never going to be able to have encompassing regulation that allows the financial system to work reasonably effectively.

The (inaudible) relates to one that I am particularly concerned about and which in fact I think some of the other panelists will talk about, which is trade. Here there is a serious concern that given the very difficult situation the world economy is in right now, there could be either implicit or explicit protectionist pressures arising in a variety of countries. Again this is perceived in different ways by different countries because if you think about the U.S. actins to support the financial system, to support the auto industries and so on, it is quite easy for other countries to see these as protectionist policies. After all, the U.S. has for a long time argued that subsidies given to industries by other countries are protectionist policies of a sort, so here things are going to get extremely dicey as countries look to their own interests in the short-run. Here I hope the Obama administration will be able to lead effectively in terms of first of all making clear that the policies that it is putting in place so support domestic industries are temporary ones, that these will be retracted, that there will be no perpetual subsidies to domestic industries. Second, to think about putting on the table some initiatives from the U.S. side in order to get the trade talks started. Of course there was a variety of reasons for the impasse. It was not just the U.S., but a variety of other countries that were essentially not bring enough to the table. But here I think the U.S. has a real opportunity to take a leadership role in terms of getting the multilateral dialogue starting again rather than giving in very easily to the protectionist pressures.

In terms of engagement with the world economy, and this will be related to my next two points, I think the U.S. needs to think about both multilateral and bilateral dimensions of its engagement with its major trading and financial partners. In terms of the multilateral engagement, one thing that the crisis has shown us is that it is not just financial policies either domestically or internationally that are important, but macroeconomic policies have a very important bearing on the outcome of weak or inappropriate financial policies and the term global imbalances or global macroeconomic imbalances has of course come back to hurt us with a vengeance. When the U.S. was running large current-account deficits and it looked like the rest of the world was going to sustain them by financing the U.S. current-account deficit, some were arguing that this was in fact a sustainable outcome. Clearly it's proved unsustainable but in a very specific way. Many of us had assumed that a correction would come through a sharp depreciation of the U.S. and a very sharp adjustment in the U.S. current-account deficit. That has not happened. In fact, we have a perverse situation right now where the rest of the world still seems to be looking to the U.S. to sort of pull it out of the slump and clearly this is not on. If you think about what drove U.S. consumption, it was very high levels of consumer debt, it was a very high level of public deficit, and both the government finances need to be repaired and household balance sheets need to be repaired. So it is hard to see the U.S. as being the leader for world demand yet again. But the concern is that this is in fact how many countries including China for instance are viewing how things should pan out, that they still view exports as being a very important part of their growth strategy. And it is not just China, but a variety of other countries as well that do view exports as a critical element of their growth strategy. Here I see a potential danger to the global macroeconomic imbalances. If anything could slightly worsen in the short-term and if this gets tied into protectionist and (inaudible) trade pressures, we could be in for a relapse in the near-term. So this is something that will have to be guarded against.

But in terms of thinking about this complex of macroeconomic policies the question is who is the rule setter and the rule -- here it is clear that we do not have effective governance at the international level. An institution like the International Monetary Fund could potentially play this role. After all, it is seen as a reasonably independent arbiter of economic policies. But that independence has come into question in the last few years when there was the notion that the IMF for instance was largely doing the bidding of the U.S. So I think thinking about reform of an institution like that the IMF so that it becomes a much more effective arbiter of macroeconomic policies not just for the small countries that borrow from it but for the larger economies including the U.S., the other G-7 economies, and the other large emerging-market economies like China it is going to be important, and my colleague Colin Bradford has written a great deal about changing the rules of IMF governance which I think is going to be very important because ultimately we do need a sort of policeman who sets the rules of the road not just for the small economies but for the broader macroeconomic system.

In addition to multilateral engagement, I think bilateral engagement is going to have an important role as well in terms of U.S.

policies toward the rest of the world and there are mechanisms already in place for a variety of these. One of the most important relationships of course is with China and the strategic economic dialogue that was initiated by Hank Paulson has often been criticized for not delivering much in terms of substantive content. I think it is still very useful as a tool to generate ideas about how to tackle problems and this I think is the crucial link that is missing because ultimately much of the focus in terms of discussions between the U.S. and China especially in the political sphere that we live in in Washington tends to be about the U.S.-China bilateral trade imbalance or about the U.S. dollar versus the renminbi exchange rate, and ultimately there is a much broader set of issues in terms of the global macroeconomy that are important. So if you think about the exchange rate, what matters is not just the U.S.-China bilateral exchange rate, but what is happening with Chinese exchange-rate policy and what implications that has for China's growth. And as I have argued in some of my writings, I think the real reason we should be thinking about exchange-rate flexibility in China, and I say flexibility and not just a one-step appreciation as some people have argued especially in the past, but flexibility would essentially be very important in terms of getting China a more independent monetary policy which in turn will help the push forward financial-sector reforms which I think are going to be very important in the long-run in terms of rebalancing growth in China and rebalancing growth in China toward more consumption rather than investment and export-led growth is what the Chinese want as well. So here there is a commonality of interests because this could serve U.S. interests much better if China grows in a sustained in more balanced way once we come out of the crisis of course, and this could help them import more goods, perhaps endogenously correct the trade imbalance with the U.S. as well as with the world. So I think thinking about these common interests, and there are really common interests in many of these bilateral engagements, but very often they tend to get lost in the mix when thinking about these issues of a very Washington-centric prism. So here again I hope that the Obama administration both in terms of this multilateral engagement and in terms of these bilateral engagements not just with China but with other large emerging-market economies like India and many of the other Latin American countries could really make a very significant progress, again to think about these as cooperative partnerships rather than as those where the U.S. is out to get something specific from the counterparts on the other side.

So ultimately I think this is a great opportunity for the Obama administration. It is very tempting to think about Obama as being a president of the world. That may be too much to ask of him given how much he has to deal with even in the U.S., but I think being a statesman for the world is something that would ultimately serve not just the U.S. but the global economy as well much better.

MR. BLUSTEIN: Eswar, thank you very much. We will now hear comments from Barry Bosworth and Colin Bradford.

MR. BRADFORD: Barry is going first.

MR. BLUSTEIN: Barry, why don't you go first?

MR. BOSWORTH: I think there is much that Eswar said that I agree with. I think in many respects this is an opportunity. But with some of the things that have been said recently about the global aspects of this without getting into the U.S. problem, I would have a slightly different emphasis I guess.

I think the most important thing for Obama to keep in mind is that like the 1930s, this is a global crisis caused by a screw-up in the United States and there's a real temptation right away for Americans to try to shift the blame elsewhere. It should be very clear that this is an economic crisis that originated here in the United States in the same way that the crisis in the 1930s originated in the United States and it then spread to the rest of the world. I do not think the crisis in the United States will turn out to be as bad because I hope we have learned something about how to deal with such things, but the crisis in the rest of the world might be worse because compared to the 1930s, this is a much more globalized integrated world economy. In the 1930s we could have said this was of no consequent at all to Asia. They were unaware that anything had happened. Most of Europe outside of Germany and the U.K. was not that severely affected.

Not this time around. This time there are going to be very large implications for the rest of the world so I think that the United States has to start with the recognition that it has got a special responsibility for having caused these problems and trying to straighten out what has happened here in the United States and in the way we do it, taking account of our implications of our policies on other countries. I think one big lesson that comes out of that is that we need a coordinated economic response. I think what we needed was exactly what was discussed at the G-20 meeting last fall. And I would be optimistic in the sense that it seems to me there has been a lot of follow through. There has been a lot of coordination. There are a lot of fears raised by American economists about what could go wrong. But in fact so far it has gone very well if we are talking about a coordinated strategy.

I would say if you look at Europe that they have similar financial problems to the United States, they did not have the impetus of the mortgage crisis, but the basic problems with the financial system, excessive risk taking, are very similar to the problems that we face in the United States. But in Asia they essentially have no significant financial problems. They have not been impacted by the financial side of this crisis. To them the impact is coming from the trade side and there is a collapse taking place in Asia of really extreme dimensions, the speed with which trade is falling between countries. I think it is a bit of a puzzle about what it is declining so fast, but in November we saw declines in trade across many countries in Asia of 25 percent in a single month. I worry about what it is going to be in December.

But in terms of coordinated responses, number one I think everybody should realize there is almost nothing that can be done to stimulate the economy on the monetary side. The U.S. has taken interest rates to zero and other countries are following that pattern. What we are going to try to do is see if we can't at least maintain some global liquidity, but the stimulus to get us out of this is going to have to come from fiscal policy. The United States is in a very weak position to take the lead because you could not image a country more in fiscal chaos at the beginning of a financial crisis than this country. But we are going to have to ignore those restraints and in the short-run the only choice the United States has is a huge fiscal stimulus of exactly what the new president is talking about. I do not see that we have any other option, and I think he is quite right that maybe the lessons from the employment report today will reinforce to the Congress that this is a very severe economic downturn that is taking place here in the United States, and we think we know how to manage it but we have not done anything yet.

So when you look at fiscal policy, we have a lot of talk, but we have no plan. We have no action taking place in Congress at the present time. We hope there will be in the next week or 10 days something introduced to the Congress, and then it appears they want to argue about it for a month or two. We are not clear when it is going to emerge. It is going to require a lot of political constraint.

On the other hand, if you look throughout Asia, Asian countries have already begun to act. China has announced and begun to take action on a very large fiscal policy action. American economists immediately respond I do not believe they are going to do all that. I believe it. But even if they did have of it, it would be a lot bigger than the U.S. economic policy stimulus that we are talking about. So I think that we are too quick to try to criticize other countries for the problems that have started here in the United States.

Similarly, on the trade system I think it is legitimate to worry about the problem of protectionism but we should recognize that so far it is going very smoothly. I know of no country that has taken major protectionist trade actions. We worried last month that China would begin to let its exchange rate depreciate, but in fact they did not do that. It has continued to appreciate slightly against the dollar. We worry that Japan would intervene when the yen rose to such extreme levels. Japan never intervened. So on the exchange-rate side, countries have adhered to the rules of the game it seems to me very well. I worry more about the implications here in the United States of protectionism because I remember the history of the 1930s. Having caused the crisis, what was the American response to the global aspect of it? Protectionism. And I think it is very important for Obama to be sure to avoid that threat. I think he will because I think he has strong economic advisers who are very open toward global trade.

But for the United States this is very important because I think if we are going to get out of this mess, we are going to have to do it by exporting more. The years of the consumption binge in the United States are over. We have to find some way to rebalance our own economy, raise our national savings, and if consumption goes down and savings goes up, the only offset is exports. If we are going to export, we need a strong global trading system, so we have a very big interest in promoting that sort of action. So I think that is an area where the United States has to take the lead.

On our new trade policy, I just do not think it is realistic to reopen global trade negotiations. I want to hang on to what we got. There is no consensus in the United States on trade, and one of the big challenges that we will face over the next 4 to 8 years is how do develop a consensus in the United States that is not purely partisan on what to do about trade and how trade benefits the United States. I think we did not do anything in the last 8 years to build such a consensus, that we just pursued extremes by the two parties. I hope that Obama can do something. But in the short-term, I do not think it is realistic to think that we are going to have some trade negotiations, and Obama will have no authority. The fast-track authority of the Congress has expired. There is no chance he could possibly get it reinstalled anytime in the short-run. So I think the focus of our trade should be on trying to make sure there are no steps back, avoiding at all cost any kind of protectionist measures, and continuing to be very cooperative with other countries in a coordinated response.

I think if we can manage all this, the opportunities in fact in the long-run could be beneficial. I think this is the triggering event that for the United States is likely to lead us in the long-term toward a rebalancing of our economy back to a more rational structure with less emphasis on consumption. And I think we are already seeing in China -- what were the benefits of their stimulus package? What did they focus on? Stimulating domestic demand. That is exactly what they have to do. And so everything China is doing in the short-run is very consistent with where they ought to be going in the long-run, to reduce their dependency on an unstable and unpredictable global economy and move back to greater emphasis on growth the way they were doing a few years ago. So I think the U.S. could also after this crisis, the most immediate aspects are over, evolve in the same way.

So I think the message that comes out of this to me is that the new administration has to recognize the American responsibilities for what has happened and really take the lead in trying to coordinate responses to it. Finally, it is very important that we avoid trying to take actions of beggar they neighbor nature that try to shift the burden on to other countries.

MR. BLUSTEIN: Thank you, Barry. Colin?

MR. BRADFORD: Thank you. It is difficult to follow such good presentations by my colleagues who I largely agree with, but let me try.

I think the president-elect has focused on domestic issues for the time being and I think he has given the public and the world the right sense of emphasis by doing so. What he faces on April 2 is the second meeting ever of an expanded global summit, the G-20, in London, to follow-up on the one on November 15 which dealt with the global financial crisis. What I would like to do is outline three things that are consistent with the previous presentations that I think are vital to come out of that summit.

The first, building on what both Barry Eswar have said, is that fiscal policy coordination and public investment coordination among the major economies represented in the 20 is crucial for a global outcome. Nobody has a bigger stake in this summit than Gordon Brown who happens to have been the former finance minister of the U.K. as you well know, and no country as Barry especially has pointed out has a bigger stake in the outcomes of this than the United States. What is a truism in economics that has been long proven since the inter-futures (?) model at the OCED in the 1970s is that if 20 major countries like those represented in the G-20 were to engage in coordinated fiscal policy expansion and public investment of significant magnitude but proportionate magnitude in relation to the size of their economies, then the multiplier effects of the multiplier effects that you get from stimulating demand in this fashion are more than they would be if countries acted singly for sure. And it means, secondly, that the exchange-rate implications of that fiscal expansion if done proportionately to their GDPs are undisruptive to the exchange-rate markets, whereas if countries go it alone and some stimulate and some do not, some stimulate by 1 percent of GDP and some by five, you get imbalances in the system and you get exchange-rate repercussions from that kind of uncoordinated expansion. So I think without doubt even though it was only one line as I recall in the communiqué or declaration from the G20 summit on November 15, is this needs to be a pillar coming out of actual commitments. As Barry pointed out the Chinese had made a commitment of $686 billion in public-investment programs before the G-20 on November 15 which was not matched by everybody else, but I think by April 2 they need to be.

The second area where I think there is the need for real attention on the part of the leaders of the G-20 is this whole area that Eswar emphasized which is financial regulation, oversight, and supervision. It is quite clear that the United States has not been minding the store on this front. It is a clear abdication of public responsibility and of institutional failure that we have not been able to keep close enough eye on the workings and dynamics of our financial markets to prevent this from happening. And I think I would err on the side of saying I agree with Eswar that we should not move quickly on this, and I will give you a proposal in a second, but I do think it needs to be clear that this is a failure of taking public responsibility and that some kind of public institutional innovation in the United States especially but in other countries as well needs to take place, and here is the proposal that I have made before but I will make here. The way to do this is to give priority to domestic oversight, domestic institutions, processes, and mechanisms, for oversight, supervision, and regulation of financial markets, and building on that you get to a place where you then can talk about how to regulate to deal with the international financial flows which are also significant, but you do not start with this idea I think that was prominent around the time of the first G-20 summit of the College of Supervisors because the problem is not that you cannot solve the problem just by regulating the international flows, that the problem originated as Barry pointed out in the United States and it was a domestic failure and so it was a domestic institutional failure, so the question is how do you correct that.

What I have proposed is that the IMF take the lead in setting up essentially three tables in a style that is common at the OECD in Paris which is a policy table, you would set up three of them in my view, one on oversight, one on supervision, and one on regulation, and you would invite members of the institutions, officials from the institutions, of those three respective domains from the 20 countries to come to Washington, sit around the table as you do at the OECD, but the OECD is not the place to do this for obvious political reasons because the membership is biased in the OECD, and you undergo peer review and sharing of comparative experience with a view of each country, each government, drawing lessons from what it learns about the behaviors, mechanisms, institutions, and processes, in other countries. The United States I think has a lot to learn. The fact of the matter is there was a process like this in the G-20 called the Financial Sector Assessment Program in which studies were done of the financial sectors of most of the G-20 countries and the United States demurred and did not do an FSAP as it was called. As Paul Martin pointed out at the time of the G-20 summit in November, the former finance minister and prime minister of Canada, who knows what would have happened had the United States undergone that G-20 FSAP process and made some changes in its institutional structures, maybe the whole crisis would not have happened.

So I think that does two things at once. What my idea is, I want to be clear about it, and it is consistent with what Eswar has said about the timing and the deliberateness and the carefulness with which this needs to be done, you are not trying to have the IMF dictate solutions on this front, you are not trying to have countries come to the table so that they can emulate or imitate the success stories of some other countries. Rather, what you are using is the policy table as a catalyst for the exchange of experiences and views so that countries can selectively borrow for themselves institutional lessons which can apply and take hold and be effective in their own domestic domains. It is a very different process than the one we normally think of where the IMF in its wisdom comes up with a solution and everybody is supposed to swallow the medicine. Rather, it is officials coming to the table to take away from the table what they can to innovate at home. I have worked for 4 years at the OECD. I was the representative from the United States to the donor coordination meetings for 4 years at the OECD. That is the way the OECD works. The fund is looking for a mission and this is a mission that it could take on in a universal membership organization rather than the OECD which is more limited and much less the Basel-based institutions which are very Euro-centric. And my fear there is, and this leads to the next topic, that there will be changes in the membership of the Basel-based institutions I think as a result of this crisis but they are going to add four new members and not 14 which is what they need to do.

So that leads me to the third topic which has been touched on here especially by Eswar which is the international financial institutions and especially governance at the IMF. My view is that the IMF and the World Bank, especially the IMF, is not in fact today a true multilateral institution nor a true global institution. It is a transatlantic institution and it is an institution in which the United States has a veto which is inconsistent with the very idea of a multilateral institution. The fact that it is a transatlantic institution is embodied in the fact that the Europeans sit on eight of the 24 seats, have 34 percent of the vote, and name the managing director of the fund. The problem across the street with the World Bank is that the same sort of proportions apply but not quite so starkly because of two different configurations, but the United States names the president of the World Bank, and if we did not learn anything else from the Wolfowitz crisis, we must have had to stare in the face the degree to which this idea of having a president of the United States name a crony as the president of the World Bank does not work. So the thing I think that could happen and should happen at the G-20 summit April 2 in London is that Gordon Brown should collar his European colleagues, they should get on the phone with Obama, and they should decide before the meeting and announce at the meeting that the United States and Europe are prepared to renege on their privileges of appointing the heads of these institutions and open it to a process of competitive, open, merit-based selection of the heads of these institutions.

It is true that a European and an American can still win in that open, competitive, merit-based competition, but it is a very different thing to have Bob Zoellick named or even Paul Wolfowitz for that matter, nominated and be part of a selective process of merit-based selection rather than to be named by the president of the United States or by the Europeans in the case of Sarkozy who simply named Dominique Strauss-Kahn out of the hat in Brussels as you will remember. This is not an acceptable procedure. The Asians do not see the International Monetary Fund as being their institution, they see it as a Western transatlantic institution, and since Asia is obviously important, the thing we have to do is make big gestures, not move around 3-1/2 percentage points of voting shares and think that that is enough, we have to make big gestures. So I think that coming out of the G-20 summit, a major way to signal an interest on the part of the European and American governments in significantly changing the governance structures of the Fund and the Bank is to make these two bold and needed gestures which are absolutely essential for any other further reforms on merits-based selections and giving up on the veto on the part of the United States.

So it seems to me that this would have an effect I think of engaging Asia where Asia could feel as if there is a process underway to make room for them at the table which would need additional measures which are much more tedious and much more difficult. Do not kid yourself. Moving significant chairs around on the board of the Fund and the Bank is a very, very difficult thing, but these gestures are things that can be taken by our own governments and they need to be done and they signal a change of heart and a change of mind on the part of the West in relation to the rest of the world. Thank you.

MR. BLUSTEIN: Thank you, Colin. Before opening it up to questions I am going to toss a few first at Eswar and then another one I would like to toss at Barry. Eswar is the financial crisis likely to create a backlash in emerging-market countries about financial globalization and innovation especially since the U.S. was seen as overly pushing this agenda and to what extent would that backlash be merited?

MR. PRASAD: That is an interesting question, Paul. The way you have characterized it is just right in the sense that the U.S. was seen as pushing its agenda on the rest of the world and in terms of thinking about for instance access that U.S. financial firms had to other markets especially among the emerging-market countries thinking about what capital account liberalization would mean for U.S.-related financial flows and thinking about what financial innovations in those countries would mean in terms of benefits for U.S. firms, it was seen as a very U.S.-centric approach and the problem is that much of this took the form of hectoring by the U.S. about what other countries should be doing because look how robust and resilient our financial system is. That picture of course is not going to work terribly well. But having said that, I am actually very encouraged by the way many emerging markets are approaching --

two countries I study in particular are China and India and the responses there have in fact been much more mature in the U.S. where you had some of these knee-jerk reactions like shutting down short selling, so that was a key determinant of the problems in the equity markets for instance.

Let's take China for instance. Very soon after this crisis started developing, Chinese officials in fact came out and said that although of course this is going to change their views about how to move forward with more exotic parts of financial innovations and so on, they felt this was even more reason why they should push forward with very basic financial development and financial development in many emerging-market countries means something very different than it does in the U.S. which has a much more advanced financial system. There it means the very basics of getting the banking systems on their feet again and working well in terms of getting plain vanilla innovations like currency (inaudible) markets working better, developing ancillary markets like copper and bond markets, and finally this notion of financial inclusion which is getting more people in the economy into the -- getting them more access to the formal financial system. So in fact on all these fronts in fact there is continuing progress in China. And likewise in India which had gotten a little further ahead of China in terms of its financial reforms, there was this big concern about a backlash against all forms of financial development and in fact the regulator of the Securities Board was asked this question explicitly whether he was going to ban short-selling because after all the U.S. has done it, and his response not in so many words was that that is not the problem and that is not quite the solution either. And India has been moving forward. The currency (inaudible) market was set up just about 3 months ago. It has been booming since then. So in terms of these basic aspects of financial development, in fact I think these countries are moving forward but I think they are doing it in a way that is much more measured and without this pressure from the U.S. and I think frankly this suits them much better to proceed at their own pace taking cognizance of their own constraints, institutional characteristics and so on.

I still think some prodding in order to get these things going, because after all even in these economies there are some forces that would prefer not to see any sort of financial development. They would like to see all the banks remain completely nationalized, and of course being in the U.S. it is a little hard to talk about banks not being nationalized given the way we are going with our banking system here, but at least the administration tells us that the objective is to get the government out of the banks fairly soon and perhaps we should do it at the same pace as the other emerging markets. But in terms of those types of reforms that are still necessary in those emerging markets, I am quite encouraged and here I think again the Obama administration could actually play a constructive role in these processes of the emerging markets by taking away the hectoring part, but giving the emerging-market countries what they actually need in terms of some degree of technical assistance, in terms of guidance on many things which in fact some of these emerging markets are looking forward to. Surprisingly enough despite what is happening in the U.S. financial system, it is still seen as having some elements right. So I think there is an opportunity here for the U.S. to help in the broader aspects of financial development but with the recognition that a more back-to-basics approach might actually be something that works much better for the emerging markets.

MR. BLUSTEIN: Let me ask another question, going back a little more in history. It is of course important to understand the historical roots of the crisis before we figure out what to do about it. Treasury Secretary Paulson, Fed Chairman Bernanke, and others have argued that successive savings in Asia was one of the root causes of the financial crisis. In your memo you say that the global imbalances were not root causes but they added tinder to the flames, and I would like to explain -- tease out your reasoning on this a bit more. Perhaps Barry would also want to comment on this. If the imbalances had not existed, would a crisis of some similar magnitude of what we are having now have happened anyway? I realize this is an absurdly hypothetical question. To what extent were the imbalances truly a cause or just an extra little bit of fuel?

MR. PRASAD: Barry has touched upon this and I largely agree with what he said. There has been especially in the last 2 or 3 weeks the notion that has been floating around from the present administration that it was largely the fault of the rest of the world's making whether than the U.S. making it, and I think Barry hit it right on the head that this is a crisis that originated in the U.S. If you look at the profile of the numbers it is very difficult to argue that say a country like China was critically important in terms of so to speak allowing the U.S. to do horrible things. If you look at Chinese current-account surpluses, until about 2005 in fact they were relatively modest, just in the range of about 100 to 150 billion. It was only in 2005 that the Chinese current-account surplus reached 150 billion and this year it is likely to perhaps touch about 400 billion. The U.S. current-account deficit is about $750 billion, could be in the range of $700 billion to $800 billion this year. So if you start adding up the numbers it looks like there was a certain aspect that the global macroeconomic imbalances may have allowed the problems to fester and did not allow the equilibrating mechanisms that normally would have come into play from taking place so the normal circumstances of the U.S. government borrowing debt continuing at the very high levels that it did in the early to mid-2000s and if you had national savings rates that were as low as they were in the U.S. you would have had interest rates rising in the U.S. and that would have essentially prevented the problem from becoming as large as it did. So I think the global macroeconomic imbalances did play a part in letting things become as bad as they did but I think to argue that those were the root cause of what we are going through right now is clearly, as I have argued, "truthification" deals, one of Stephen Colbert's wonderful words.

But in thinking about global macroeconomic imbalances I think it is useful to take a step back and think about what they really signal in terms of what is wrong with the global economy and I think here one can argue that the policies that one sees in different parts of the world may in fact have something to do with the global macroeconomic imbalances. So if you take the Chinese exchange-rate policy, it had something to do with Chinese financial market development or underdevelopment which in turn has made it much harder for them to rebalance growth. In the U.S. you had the large fiscal deficits and excessive mucking around with the financial system and financial innovation that let these imbalances get out of hand. In Europe you had a variety of structural problems. But if you take all of these together and think about what the implications are about should be done to deal with global macroeconomic imbalances then actually things become a little less clear. In the U.S. I think the picture is a lot clearer. Again the priority right now is to use fiscal stimulus to get us out of the crisis but over the medium-term clearly the fiscal position of the U.S. is simply not sustainable.

In the case of China I would argue that financial-market development is crucial in terms of rebalancing growth. That should in principle lead to the Chinese saving a little less. Perhaps they need less for precautionary reasons as growth becomes more balanced. Perhaps they may have incentives to borrow against their future income and raise consumption and have more diversified sources of income, a better social safety net which could all lead to increasing consumption and reduced savings. But if the financial system did start working very well, perhaps capital would be better allocated and perhaps investment might actually decline. So in terms of the current-account balance is of course there is the savings-investment balance. What happens to the current-account balance in the short-run is not entirely obvious when both savings and investment are declining. So in the short-run, in fact focusing on the current-account imbalance may not be the right approach but I think macroeconomic imbalances of the sort we have seen in the last few years do suggest there are things wrong in very different parts of the world economy and we should go back to thinking about those root problems and solutions thereof.

MR. BLUSTEIN: Barry, do you want to jump in on that?

MR. BOSWORTH: These are kind of complicated and they take us far afield, but I find the whole notion that somehow the Chinese did it to us is just absurd.

MR. BLUSTEIN: That is not my question.

MR. BOSWORTH: But it is. We have a global imbalance that started in the United States. As Eswar was saying, there was no imbalance in China back in the 1990s. We have been through this before. Americans do not care to save very much, we get a savings and investment imbalance and the rest of the world is happy to lend us money and they are happy to export to us. Right? Which is a good deal. We love to consume, they like to produce. We have been through this with Japan. I am old enough I think. I listened to this discussion on China and I think I can hear the same conversation, just change the word from China to Japan, and it is the same nonsense that you heard in the 1990s and we are right back in the same discussion.

Countries have to act in their own interests. What I do not disagree about China is I think that their growth policies got offline in the last couple of years. I think they realize it. I think they are going to use this stimulus package as an opportunity to shift back toward promoting more growth domestically because that is where their growth came from the 1980s and the 1990s. The real dilemma and the problem as Eswar was hinting is for the United States. We got a real problem. We start this with a budget out of control and a huge current-account surplus and then somebody says, What do you do to get out of this? You borrow a lot of money and spend it. That is not exactly very good if you are thinking about the fiscal situation, and it not exactly very good if you are thinking about our international situation. But luckily so far there are no signs at all that the rest of the world is not eager to loan us money at zero rate of interest, so we might as well take advantage of it and apparently Americans are willing to loan their government money at zero rate of interest and I think we have no choice, but as been emphasized, it is going to be very hard for the United States to turn this around. Hopefully 3 years from now we will have to go back the other way. When this happened to us in the 1980s, it took almost 20 years. If you go back to 1980, all of a sudden we started to run these huge fiscal deficits, we built up the big current-account deficit, the thing blew up much smaller scale than today, and then starting in the Luvacore time of 1985 it took us 5 years to get the current-account balance back down by the early 1990s and we waited another decade to get a fiscal surplus. That is 20 years of trying to undo this whole situation. And now the United States is right back in the same mess doing the same thing but the combination of time has been compressed on us.

So I think we are the ones who face the huge challenge about how to restructure our economy, become much more export oriented, raise national savings, and at the same time stage all this. I think Obama has taken on an enormous task and this effort by American economists and policy makers like the Secretary of the Treasury to shift the focus that somehow one-tenth of this problem may be due to the actions of other countries and therefore they should be upset about it I think is the wrong focus. We need some real harsh language for Americans to adjust to.

MR. BLUSTEIN: Colin?

MR. BRADFORD: I would just like to add that I think there is a major transition afoot in the United States in that the new administration seems to understand something that the Reagan administration and the Bush I and Bush II administrations did not and that is the meaning of fiscal policy. I do not think it is an exaggeration to say in the 1980s that Ronald Reagan had a defense policy which meant that government spending had to grow and he had a philosophy of government policy which was that government should be small on the domestic economy and no one walked into the Oval Office and said but Mister President there is a G minus T problem here or a T minus G, that is to say, that there is some relationship between government revenues and government spending and as a consequence the big fiscal deficits against constant monetary policy drove the current-account deficits -- the fiscal deficits drove the current-account deficits just as Barry described and it took a long time, 15 years, to correct them and then we reran that movie again with the substitutions -- we had the Japanese and Chinese thing is exactly right. So now we have I think a situation where in the articulations that you hear the president-elect making is that he is concerned about how to mesh current short-run needs that are clear and urgent with long-run sustainability. That is not going to be easy and one of the questions that does concern me is that the debt to GDP ration rises in the U.S. as a result of the stimulus package do we run the risk against the background of global imbalances which are not causal but could be contributory to a difficult problem, is there a flight from the dollar where people are unwilling to pay for these deficits and then I think we have a problem that is on top of what we have already got which could be grave.

MR. BLUSTEIN: This gentleman here had his hand up first I think. And could you please identify yourself? People will be coming around with microphones.

MR. REINHART: I am Arnold Reinhart formerly with the IMF and the European Central Bank. Remember Paul we used to talk quite a bit?

MR. BLUSTEIN: Yes.

MR. REINHART: I would like to make three quick points. The first one has to do with casting back our view to the Asian crisis as you suggested, what lessons did we learn? Perhaps not too many indeed, and I was going through my files just the other day to look again at what happened and I was on the board of the IMF so I remember certain things and I wanted to look at it in more detail. I have extensive notes. I came across a quote by Alan Greenspan dated December 24, 1997. This is at the very point where we finally were able to get the Korean crisis under control, bringing in the private sector as you will recall and you have described very ably in your book, Paul. Here Greenspan is saying a lot of blame on the crisis falls on the Asian countries themselves because they were very negligent in their supervision of regulation with regard to the financial sector. I will not comment on this further.

Now my second point has to do with trade and protectionism and I think Eswar made some very relevant points. Barry also said so far so good. I think that is right. We are not seeing an outbreak of protectionism perhaps yet although there are some ominous signs. The

Chinese were I think working toward some subsidization of exports. There are noises in this country but also in Europe I have to say that are making me a little nervous, and we have not reached the height or rather the depth of the crisis probably. I think that at the G-20 there is an opportunity to come out strongly about trade. We are having there not the ministers of finance who cannot really talk about trade, but government leaders and they can and I think they should come out with some sort of trade pledge more formally than just putting something in a communiqué where they say we will refrain from taking protectionist measures and hopefully they will stick to it.

And I would also like to say that whereas I think it is good to engage China perhaps also on a bilateral basis as the U.S. has been doing, I think a more fruitful approach is to do this in a bigger group. The G-20 is probably too big, but the IMF had an initiative a few years ago of a multilateral consultation exercise where five major countries or country groups, the United States, China, Japan, the Euro Area and Saudi Arabia, were brought together to discuss at that time the global imbalance problem. That initiative did not bear a lot of fruit. I participated in the very first round of meetings and I thought it was pretty encouraging, but then at some point where things became a little more difficult we never got a ministerial meeting unfortunately and the United States did not want it and

China did not want it. I think the Europeans were the most positive about it. And a very positive effect of this was also that it forced the Europeans at least the Euro Area countries to speak with one voice. That was very encouraging and we need more of that.

Which brings me to my third point, and this is the representation within the international financial institutions and I agree with Colin that further change is needed. What has just happened with regard to the quotas is not terribly impressive. There is a discussion going on among the Europeans which can of course become stronger with further external pressures and I note that within the G-20 communiqué of November there was some pretty strong language about this and I think further progress is needed. Let me just say that whereas the Europeans have a large share of the vote, they did not use it very effectively often in the international financial institutions, having trouble speaking with one voice.

And finally I think there is a way to change things if you simply take out intra-trade for the Europeans in the quota formula, you just get rid of the intra-trade variable, you do see a big change so that that might be an idea. Thank you.

MR. GEROVSKY: I'm Berd Gerovsky, New Rules for Global Finance. I hear a lot about U.S. guilt and obviously there are some imbalances there and all that, but let's not forget it was anyhow the Basel committee that with their minimum capital requirements and empowerment of credit-rating agencies setup this misguidance that drew all these funds of the world into the subprime crisis. So there is a shared role.

Having said that, when I read today restore global finance stability, sometimes I feel that the most important thing before us is to keep whatever finance stability we still have which at this moment definitely is the dollar as the system because the dollar is the world currency. And hearing so much from this shop until drop and they dropped going over now into stimulate until we drop gets us a little bit worried about where it is going to end. And so from the perspective an outsider or foreigner that is having his money in dollars, we are not hearing those things that would make us feel a little bit more comfortable like we want a one dollar -- and this hurts me a lot because I come from an oil-producing country, but like we want a dollar per gallon of tax revenue neutral if you want immediately to show that the U.S. is serious about putting their house in order. Those things that the market wants to see, some messages that there they are serious about putting their house in order they are not really around, and the stimulate until you drop is not enough. That is more scary.

MR. BLUSTEIN: If I may make one point about what Mr. Reinhart said about protectionism, because we have been talking a lot about the macroeconomics and imbalances and so forth and I think the trade is as someone who is writing a book about the WTO kind of important. Actually the G-20 did make a pledge in its November communiqué saying let's have a standstill on protectionism. It was rather promptly violated. Of course the Russians were the biggest offender and immediately and not soon thereafter they were raising taxes on imported autos, though they had some argument that actually this was in the pipeline before November 15 or whatever date it was so you cannot impose ex post facto rules on us. The other pledge that was made of course was that nations of the world must get together within a month and reach an agreement on modalities in the Doha Round which also failed to happen. I would be very interested in people's thoughts on what could be done. Barry and Eswar had a disagreement about whether the best way to proceed is to push new trade negotiations or to just hang onto what we've got. I'm a strong believer that it is obviously crucially important, I think they would agree, that the most crucially important thing is to hang onto what we've got and to avoid doing harm. The question is how do you do that beyond these hortatory statements.

SPEAKER: Keep it away from the U.S. Treasury or U.S. Congress.

MR. BLUSTEIN: I am interested in the thoughts that people have about that, but I dare say people have other questions. Mister Secretary?

MR. COLEMAN: Bill Coleman.

MR. BLUSTEIN: Former Secretary.

MR. COLEMAN: I hope you recall that when George Washington and Hamilton defeated Cornwallis at Yorktown that it took a month and a half before the British knew they were defeated. Today however anything you say or write the rest of the world knows in about 2 or 3 minutes. I have been reading several books on the Middle East and they are awfully good, but one-third of that book I hope the people of the Middle East do not read because it tells them what to do and what not to do and what we will do. Therefore I really direct it to you, sir. I think you said that somehow the United States should give up its right to be in charge of the World Bank and I just do not think that is right. That does not mean that you should not educate whoever is in charge of the World Bank and tell him or her that there is much more you have to know. But the idea that the United States which is still the most powerful country in the world and wants to remain that way would permit other people -- and I would just ask you to look at the U.N. when that was pretty much done.

MR. BLUSTEIN: You will obviously want to respond to that, but shall we take just a couple more unless you all are ready to fire back?

SPEAKER: (inaudible) Johns Hopkins CSIS and this is related. This is also for Colin. Thank you for all of your proposals for reform of the IMF, and this relates to my colleague's question about governance reform at the international financial institutions. What set of incentives do you find in place that are different now than let's say over the past 5 to 10 years to bring about the kinds of reforms that you are proposing because I think everyone agrees that it is a good idea? I should say I agree that it is a good idea. Everyone does not agree. I agree it is a good idea for governance reforms, but what set of incentives do you see in place that are different now than in the past 5 to 10 years?

The second related question is your proposal for the IMF as a global convening authority in terms of regulatory reform which I think our panelists have argued for the reasons that that is so important, what authority do you see the IMF having, what credibility, what standing to be able to pull that kind of thing off and have a credible convening function?

MR. BRADFORD: Shall I go for that?

MR. BLUSTEIN: Colin?

MR. BRADFORD: Mr. Coleman, I appreciate your feeling about the importance that the United States has for the World Bank and certainly the World Bank is important to the United States, but I think if I answer the question about incentives from our colleague from CSIS I think I can make clear why I think that is an idea whose time now has passed. I think the incentives are precisely revealed in the financial crisis itself. We need Asia. We in the West need Asia. It is not just because they are getting bigger but because they are getting better and we have clearly already a multipolar economy which is going to become more so as time goes on. The underlying dynamics are the ones that have been alluded to here in terms of the instantaneousness of communication, the flows of people, trade, and most importantly money between economies. It is not arm's length, external sectors interacting anymore, it is domestic economies and societies that are interacting. The age of globalization is one in which domestic domains are interpenetrating each other and not ones in which exports are sort of the only link across borders. So we have an age in which order to solve the domestic problems that we have, and I am sure that the president-elect and his team understand this even though they are focusing on the domestic side, we got to put our own house in order first, but that is not sufficient. Every domestic problem has an international side and every international problem has a domestic side, so we need the Asians. China and India together have 3.5 percentage points of the shares in the IMF against 10 times that amount for the Europeans. If you are a Chinese or an Indian you are going to say this is not our institution. What are we investing our time and energy and high policy qualified people in this for? In order to have convening power, have it be a global institution, have it be a multilateral institution in which all members feel as if they have ownership in it, we have to change the structure.

A very important thing is the soft sides of our power which Eswar alluded to. There needs to be a change of conduct. I can remember as a Clinton administration official being on delegations and when we would into the room in international meetings and literally throw the policy prescriptions down on the table and expect everyone to come around to our point of view. That is simply not an acceptable way of 21st-century behavior. What is needed is something that I call incorporation. There needs to be a table like the G-20 table around which leaders come and in which different perspectives are not only expected, but welcomed and the idea of the meeting and the convening on financial sector reform that I see is not a search for authority to pick up on a word you used but, rather, to see governments exchanging views and melding a potpourri of different perspectives into something that is a common agenda. And I do not think that is being idealistic, I think that is being realistic, and I think if we do not realize that the Chinese -- we have a lot in common with the Chinese, but they are going to have ideas that we will never think of because they have a different culture, different way of thinking about things, a different way of doing things and we should welcome that and not try to beat it back and beat them over the head about their getting prices right on the exchange-rate front when in fact they have probably got something else to bring to the table and there are probably more positive ways to respond to them than we are.

So I think it is vital that as Americans we get it through our heads and Europeans as well that in this case holding onto formal power is actually to lose it, to cede power and to welcome difference in perspective and engage them and realize that we are intelligent enough to be able to incorporate the views of others to find common ground and to move forward together which we have to do. On climate change, this is going to be a very tough nut to crack and we have to crack it and the way we are going to have to crack is that we are going to have to give up something and do something we do not want to do, and in exchange for that we are going to get the Chinese and other countries around the world, not just the Chinese, to have to do exactly the same thing, they are going to have to get up something or do something that they do not want to do or give up something they want to keep. We are all going to have to do that or there is no solution to the planetary problem.

And so the whole way that we approach international governance has to change. It is not the U.S. any longer walking into the room and saying look guys, this is where we need to go and expecting everybody to follow.

SPEAKER: Incentives are a changed international system.

MR. BRADFORD: That's right, and changed reality of horizontality and integration and interdependence which is so deeply embedded now across domestic societies, economies, and polities, that you have to behave in relation to the other, you cannot just behave in relation to yourself, and everybody has to come to the table with that view that you are not going to get what you need out of the world economy for your own domestic reasons unless you are willing to give up some things to fit into it in a collective way that benefits everyone so that you in fact benefit from the sustainability and stability of the common good.

MR. BLUSTEIN: The gentleman right here.

MR. CHEN: I'm Jian Chen from Fannie Mae. I am kind of a subprime bond manager there and I also teach a finance course at Johns Hopkins University. I have to make a disclaimer. What I am saying here does not represent my current employers or any of my past employers.

Here are my questions. I think a lot of people compare the new President-elect Obama to President Roosevelt because we are facing the problems and actually President Roosevelt created Fannie Mae back in 1938 as a way to promote homeownership and provide liquidity to the housing market. My question would be what is the new administration going to do with Fannie Mae and Freddie Mac. That is kind of a very specific --

MR. BLUSTEIN: I'm sorry?

MR. CHEN: What do you suggest for the administration to do with Fannie Mae and Freddie Mac? But in a larger sense, what does the new administration need to do to fix the housing finance system? Basically as Colin and Barry said, this is a systematic failure. Every link in the housing finance system has failed from the mortgage broker originator to the investment bank to the regulator to the rating agency to the GSE, and also a lot of this is driven by the government policies. To some extent from the Clinton administration or the Bush administration they have promoted for homeownership (inaudible) and Fannie Mae has a public mission to satisfy low- and middle-income homeownership so in order to do that they have to buy a lot of risky loans from low- and middle-income borrowers. So to some extent this crisis is also driven by the housing policy by the government. So my question is actually to a micro level what should they do with government-sponsored enterprises, to a larger level what should they do to fix the housing finance system because without fixing the root of the problem, we are never going to see actually a stable financial system or global stability in the financial system. So that's my question.

MR. BLUSTEIN: Do we want to take a couple more? I have seen some other hands up. Sir?

MR. AKIMBI: Good morning. My name is (inaudible) Akimbi and I am with the African Development Center. Thank you all for the good dialogue. But my first observation is that out of 6 billion on the planet Earth and the continents involved, Africa was not mentioned at all day here and we are still part of a billion-strong in global functions. The issue of the American economy, they say where I come from where America coughs, they say the rest of the world catches a cold. In Africa we say we catch a cold and a fever at the same time because we do not have nothing too much to start with. The second one is to say if a person has a headache it is the whole body that will feel it. In Africa we are feeling it more than anybody else at this point.

I guess my question then is this. I had an opportunity to look at a book recently called "Kicking Away the Ladder" which is the basic concept how the industrial nations of the world use certain programs to develop their economies and when they get to the top of this ladder they kick the ladder for the rest of us and use the World Bank and the IMF to dictate what we must do, and those things are really affecting us. A continent that is caught between the (inaudible) age and the industrial age (inaudible) way forward. What do you suggest that we do to join the rest of the global economy? Thank you.

MR. BLUSTEIN: One or two more? Anyone else? This gentleman back here.

MR. MUÑOZ: Cesar Muñoz with FN News Service news wire, Spanish-language news wire. I have a question for Mr. Bosworth on this issue of savings. If I understood you correctly, you were saying that you do not see the U.S. consumer as a crucial engine of growth anymore and perhaps I am mistaken, but I wonder if you could spell how would that come about. Will there be a restriction of credit for the U.S. consumer that will provoke this change? And what kind of repercussions that will have around the world really on restructuring economic relations between countries? And if I may, a second question. This year I guess governments will issue a huge amount of bonds, the United States and everybody else, and I wonder if you could comment on that. In the short-term everybody will buy them I guess, but this must have consequences in the future. I do not know if you see any increase in interest rates all over the world maybe in the second year or the third year. What kind of consequences that will have? Thank you.

MR. BLUSTEIN: Barry, do you want to respond to that or maybe Eswar? Barry, why don't you go ahead?

MR. BOSWORTH: I think to take the last question on savings, I think there is some question about why it is we had such a consumption binge. I think there are two arguments. One group says it is sort of cultural and change of times that Americans, for example, you have a second earner in many families now so you do not need to save. They are kind of your backstop. That may be. To me I think the most likely reason is there was just this incredible capital gains, corporate equities, and housing in the United States that drove up the wealth income ratio. The funny thing is people said we did not save anything but we were never richer. The wealth income ratio in the United States has gone up every year for the last decade. The thing has changed. It is all gone. Eight trillion dollars got wiped out in the decline in home prices and in the decline in corporate stock. We are back to the wealth income ratio we had in the late 1980s for households. If that was the driving force, Americans are going to spend the next two decades trying to rebuild their balance sheets, not spending, and that will cause a reduction in consumption. That is what most people wanted? I think that is good, our savings will go up and we will shift resources into exports. But if that is the driving force of the correction, realize it will take three to five years. It will be a long drawn out adjustment period. You do not move resources from domestic consumption to developing export markets overnight, and we learned that from the latter part of the 1980s. So I think the lesson of that is it takes a long time.

Certainly there is some concern in the future about the bond issues, but the most important thing I think, you cannot resolve any of these issue until you get a strong economy and so you have to do whatever is necessary to get a strong economy. Right now there is no problem of the United States borrowing money. The interest rate is zero. Right? In the future if it is a problem it will serve as an incentive for us to reverse our policies. The only reason that interest rates will start to rise is because the recession is over and the world economy is booming, and if that is true then what we hope this president or a future president will do is reverse U.S. economies policies and begin to run surpluses or something close to it and we might retire the public debt. That is pretty far in the future. I guess it is not my immediate concern. I would like to find a way to end the recession first.

But I do not think in the short-run worries about interest rates should constrain policy options. It is not the problem. In recessions money is cheap. Nobody wants to spend it. So it is damn good time for government to take up the money so to speak and spend it. So we should not be focusing on deficits, interest rates or debt right now, but we will have to as you point out say 5 years from now.

MR. BLUSTEIN: This question about kicking away the ladder. We can maybe take one more question. I had to turn my cell phone off because I embarrassingly got a phone call in the middle of this, but I think we are pretty close to our -- yes, we are right there. In that case, any closing comments by the two of you?

MR. BRADFORD: I think on the Africa question, I think Carlos Pascual here at Brookings is one of the people who have come up with this idea -- if I was going to mention a fourth thing that I think ought to get done, and there are a lot more things beyond this, on April 2, is that some sort of package for the lower-income countries needs to come forward and as a percentage of the kind of magnitudes we are talking about, $50 billion would probably be a lot in terms of flows. There should be a recognition that some of the costs borne of this kind of financial instability are borne by the poorest people in the poorest countries and I think there should be something in this whole thing to bring along that group.

The other thing is added resources for the IMF which more likely could also be available to the lower-income countries, significantly more resources at the IMF. You have written about this, Eswar and others have as well, and then change the governance structures around that, but the important thing is to have resources there so the IMF is a financial factor in financial markets and financial flows.

The question you also asked which I am not going to try to answer in this limited time is what should Africa do to insert itself in the global economy. That is a very good question. It has a long answer and it is not easy. But that is probably the most important thing, to figure out how to do that and especially in this time of turbulence it is even more difficult, but it is the right question for Africans to be asking and answering for themselves probably.

MR. PRASAD: Paul, can I just add one final comment? I think many of these are very important questions with no easy answers, but even in the midst of this turmoil I think it is useful for us to at least count our limited blessings. As you have pointed out, the world still for whatever reason views the U.S. dollar as a useful international reserve currency. The rest of the world is still willing to lend to the U.S. The currency is not plummeting which could make things a lot worse. Food prices are falling. Oil prices are falling. So on that parting note, things could be a lot worse. But I think really in terms of all the solutions, it is very important to think about the short-term, just getting out of the mess right now and then thinking about the longer-term issues and the longer-term issues are going to be very difficult and I think very challenging to get a handle on. And there are concerns with how we deal with the short-term have implications for the long-term but I think right now the priority is really in terms of dealing with the short-term mess.

MR. BLUSTEIN: Thank you all very much again for coming. I just want to say in closing that this conversation really is in some sense going to be funneled to the president-elect because as some of you who may have read the "Washington Post" this morning will now, somebody who works right down the hall from Eswar and the rest of us who will be in a very senior position in the Obama administration, so I think we can assume that she will be aware of the some of the views expressed today. And again thank you all very much for coming and I want to thank you panel for a great presentation, and Eswar for a very thoughtful memo and your insights on where we should go from here.

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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