

Global Crisis: Global Solutions?

Nicolas Véron

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The crisis is global, and leaves no country unharmed. No doubt remains about this.

But it is also the first downturn of this magnitude in a multipolar and economically integrated world, at least since 1914.

In such a world, the major economies share neither the same political system nor the same historical reference points, which makes coordinated action even more difficult.

France's Nicolas Sarkozy repeatedly asserted last autumn that a global crisis demands global solutions.

But such solutions are only a last resort as they are likely to be fiendishly difficult both to decide and to enforce. Regional or national responses are preferable wherever possible, including on fiscal stimulus.

Any global solidarity is out of reach, as the world is far from cohesive enough to allow it. The urgency of the moment is more modestly about maintaining an open economy in which all players have a chance to succeed.

Globalisation has allowed hundreds of millions of households to escape poverty. A new fragmentation of the system would be a massive negative-sum game. All senior policymakers around the world are aware of this.

However, fragmentation is exactly what is happening – not because of tariff increases as in the 1930s, but as a result of macroeconomic instability, international competitive distortions, and a breakdown of trust in key intermediaries. These are the key threats to address.

Macroeconomic challenges are perhaps the most worrying of all. They are also those for which the most tried-and-tested tools exist.

These include IMF intervention and the coordination of central banks, sometimes through the Bank for International Settlements (BIS) and its committees. One of these, the Financial Stability Forum (FSF), has played a constructive role as early as last April to help coordinate national responses to the crisis.

The European Union can also be helpful, as it has been with Hungary and Latvia.

Alas, tensions on the sovereign-debt market suggest that 2009 will be an active year on this front. Competitive devaluations are another major risk, to which the G7 format is no longer able to respond – if indeed it ever was.

Fair global competition entails in the short term a curb on domestic preference policies. The ongoing US debate on 'Buy American' clauses in the stimulus package will set the tone here.

It also rests on harmonised international rules in key areas of regulation.

The Basel 2 framework for banking supervision has not fared the crisis test well. The Basel

committee on banking supervision, under the aegis of the BIS, has now started review it. Progress may be hoped for in the medium term.

The crisis has also put international accounting standards, known as IFRS, in the dock. The IASB, which sets them, was slow off the mark and then overly cowed by political pressure. The prospects for IFRS adoption in the US seem distant once again.

Besides, common standards only serve a purpose if their implementation on the ground is consistent, which is currently far from being the case.

Finally, trust crucially rests on credible supervision of the clutch of global private intermediaries whose role is paramount for the whole system. For these, self-regulation is no longer enough to foster confidence.

The scope includes the big four audit networks, the three largest credit rating agencies, and key clearing and settlement infrastructure (including now for credit derivatives). These are all too globally integrated to be supervised separately in the US, Europe and elsewhere.

Investment banks and hedge funds which are active the world over may be added to this list. But their supervision on a global scale would arguably be both less pressing and more difficult.

Existing global governance institutions are ill-suited to deliver on all these items. Moreover, they all need reform.

For high-level summits, a transition is underway in which the G20 format is likely to eclipse the G7. The FSF is expanding to include large emerging countries such as China. The IMF could adapt likewise if Europe relents on its current overrepresentation and the US on its veto.

The IASB has just announced a reform of its 'constitution', but much still needs to be done to ensure that its private governance model stands the test of time.

For supervision of individual global actors, no existing arrangements are suited to the challenge. New institutions will probably be required if international financial integration is to be maintained.

For better or worse, it is now down to Barack Obama and the US Congress to drive these issues and the corresponding policy debates forward on behalf the rest of the world.

Europe, for its part, must surmount its own internal divisions if it is to manage to play a constructive role.

Success is by no means guaranteed.

Nicolas Véron is a research fellow at Bruegel. Andrew Fielding's help in translating from the French is gratefully acknowledged.