



EVENT REPORT:
**“THE CRISIS: CHANGING PROSPECTS FOR
DEVELOPMENT?”**

With Dr. François Bourguignon

After having briefly introduced the United Nations University’s tasks and goals, Dr. Coicaud gave the floor to Dr. Bourguignon, who opened his lecture thanking his honourable colleague. He then mentioned his past work at the World Bank as Chief Economist and Vice-President and referred to when he used to talk at the UN taking care of every diplomatic concern while speaking in front of an audience. The relaxed atmosphere of the lecture was far from the political concerns of his previous speeches, serving as an open academic high-level conference about the real impact of the economic crisis, its causes and possible future scenarios.

**THE ECONOMIC AND FINANCIAL CRISIS:
THE FIRST GLOBAL CRISIS OF THE 21st CENTURY**

After having mentioned the previous financial crisis of 1929, which originated in the United States, Dr. Bourguignon sketched some different scenarios for the current one, ranging from a transitory shock, which would change to a *business as usual* situation in the short run, to a more drastic scenario, where an entirely new *regime* would take the place of the old one after the recovery.

Similar to the 30’s when the concept of the **welfare state** had been created as a result of the 1929 crisis, the hypothesis of a crisis going beyond a simple shock would be the point of departure of a new line of economic policy for the next decade. Dr. Bourguignon’s point of view openly challenges easy and reassuring statements and endorses a drastic change of *regime* in the long run. Another parallel with the 1929 crisis is the presence of a huge



literature, though the best book came 20 years later explaining the reasons for the Great Depression and its effects. The same will probably happen with the current crisis. Nevertheless, Dr. Bourguignon mentioned what according to him can be considered the main causes of the crisis:

- The housing bubble, considered by him a primary cause, since we already had recently other bubbles which did not have the same terrible effects. Nevertheless, the volume of new mortgages gives us an indicator of the evolution of the housing market.
- The leverage spiral of the US economy concerning the debt/income ratio.
- The poor regulation of the financial sector, with new derivatives and other sophisticated financial products unknown to the regulatory agencies.
- The counter-policies post-September 11th in the US that have created a strong disequilibrium, especially Greenspan's aggressive monetary policy which led the Federal Reserve to sharply cut interest rates, loosening credit conditions. The global imbalance of the current account balance sheets of most of countries. This led to a strong disequilibrium between oil producing countries, the BRIC countries and Japan with important surplus while the US and the UK bore the worst external deficit.
- The growing importance of mortgage-backed securities in US mortgage market.

Dr. Bourguignon has briefly described the fast spread of the crisis from the US to the rest of the world, specifically to developed countries at first and then to developing countries with a different impact according to the exposure of the internal economy to global markets. The exposure to US financial markets' toxic assets, the previous international accounting standards based on a Mark to market standard and the credit rationing have suddenly impacted Western Europe, Japan, then Eastern Europe and Russia and the Commonwealth of Independent States. The insignificant initial impact of the crisis on poorer countries with limited access to international credit market has transformed into a huge contagion because of globalisation

Dr. Bourguignon then moved to the policy instruments needed to tackle the current crisis, mentioning:

- Concerning monetary policy, the need to inject liquidity to save banks and avoid credit crunch and unconventional zero interest rate according to the quantitative easing strategy
- Aggressive fiscal policies according to the stimulus package strategy. Yet, strong counter-cyclical fiscal policies are not feasible in many developing countries. In 2009 the injection of liquidity by the Federal Reserve in the United States has been comparable to the Second World War period to recovery from the war.

We are facing a historical moment and entering a period of slow economic recovery, but these measures are not enough, because of many contradictory factors:

- The logic of recovery is prevailing on the logic of growth
- The contraction in worldwide investments is severe
- Since American consumers represent 17% of Global GDP, the drop in consumer demand in the US will have a huge global impact.
- China and India, though doing quite well, together only represent 10 % of global wealth. It is not enough imply a real **decoupling of developing countries**.

A similar synchronisation in a global slowdown happened after the dot com bubble burst in 2001 with a similar spectacular catching up process at the global level.

Developing Countries: Inward-Oriented vs. Outward-Oriented countries.

China, India and Brazil should be treated separately from the other developing countries. The real GDP per capita growth is higher in the former category and they all share a huge internal market allowing an economic strategy for a more inward-oriented economy. The other developing countries relying strongly on developed countries' growth, have suffered from a



contagion through many channel such as trade, migration, finance and aid with a strong impact on the achievement of MDGs, which are now going to be harder to reach in the future.

Future Scenarios

An *L-shaped* scenario is widely agreed upon between economists for the next years which will be characterised by slow growth of the demand of goods and services, public indebtedness and emerging countries unlikely to become global growth engines. Private debt has been transformed into public debt, but it is still debt and a full repayment is quite doubtful. This risk of defaulting could lead to a situation of inflation, once the fire is extinguished.

A change of *regime* is going to take place in the global economy with a necessary adjustment of Chinese trade policy, development strategy and social security policies, an inevitable slow down of globalisation, a continuing North-South rebalancing, weak medium-run prospects for development of small and medium-sized countries and a climate change agenda that has to be further taken into account.



**UNITED NATIONS
UNIVERSITY**

Report written by Renato Giacon and edited by Ravi Singh