



**Title** *G20: Solutions to Global Depression?*  
**Description** In this fourth podcast Linda Yueh and Jonathan Michie discuss the G20 debates over co-ordinated fiscal expansion, global regulation, and the role of the IMF.  
**Presenter(s)** Linda Yueh and Jonathan Michie  
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**Linda Yueh** I am Linda Yueh and I am a Fellow in economics at St Edmond Hall in the University of Oxford. I am the author of *Micro Economics* and I have a forthcoming book later on this year, called *The Law and Economics of Globalisation*, which looks at the cutting edge issues in law and economics as it relates to the global economy in the 21st Century.

**Jonathan Michie** My name is Jonathan Michie. I am President of Kellogg Collage, one of the University's graduate colleges and also Director of the University's Department for Continuing Education. I thought I would introduce myself by quoting from the book I edited on globalisation 5 years ago in which I did point out that the fact that the economy is becoming increasingly internationalised, does not dictate the form that this process is taking.

The free market [ [?? 0:00:47] ] Agenda is one being pursued by those who would benefit from such de-regulated, winner takes all environment is not the only choice and, for the majority of the world's population, it is an inappropriate one. So that is what I said 5 years ago.

**Linda Yueh** It's a nice entry into this podcast since we are certainly just days from the conclusion of the G20 meeting. Our Finance Ministers are just laying the groundwork for the G20 Summit coming up on April the 2nd in London and one of the big items on the agenda was certainly how to reform the international regulatory system. And, of course, the other one, the rather small matter of how to get us out of this current economic crisis.

I thought the conclusion of the meeting was nothing that we didn't expect. They were, after all, just setting the agenda for what the Heads of State need to tackle at the London Summit. Certainly these two areas, about what we must do to get out of the crisis and the ways in which we need to think about reforming the international system, so we don't get ourselves into this mess again. Both, unsurprisingly, ended up on the Agenda for the big Summit coming up.

**Jonathan Michie** Yes, I have heard it reported - the meeting of the G20 Finance Ministers – as 'little sign of life' and you are right, maybe more will come out as they prepare for the meeting of the Heads of State. I don't know, Linda, what you saw as the key emerging issues from the G20, in terms of what they will try to achieve.

So far they seem to have flagged up the need for a more effective international regulator, if you like, but the main proposal seems to be to put more resources into the International Monetary Fund – the IMF. The problem, of course, with that is that the IMF itself doesn't have a particularly

good track record in dealing with global financial problems and so I don't think that is going to meet with unanimous applause with the whole G20 unless the IMF itself is reformed.

**Linda Yueh** Yes, I think that actually came out as one of the concrete areas they wanted to work on for the Agenda because there is certainly a huge disagreement across the Atlantic about whether or not we even need more international regulations. The Americans are not very much for this approach, whereas the Europeans see it as a very pressing issue, but they do seem to agree the IMF needs to be bolstered. Meaning that, its funds to rescue countries have to be increased.

The question is, who is going to put in the money and they were looking to countries like China and other emerging economies to do so. But understandably, if you want to increase the rescue funds of the IMF by asking developing countries to put in hundreds of billions of dollars, they rightly, will ask for a bigger stake in dictating how the IMF works.

So, we have a bit of a chicken and egg problem in that the Americans want to increase the IMF to have the capacity of, say 500 billion dollars, a figure of 750 billion dollars was floated so that countries like the Ukraine, like Pakistan who get in trouble, can be bailed out and they are asking for this from China and other emerging economies, who say in turn, don't want to give the money until the IMF is reformed and who the stakeholders are when it becomes reformed substantially.

So, at the moment, the United States has over 12% of shares in the IMF giving it an effective veto over the actions of the IMF, China has around 3% of the stakes of the IMF meaning it doesn't have a very loud voice so China is going to want a bigger stake. But that, of course means, we do see that the stake at the current dominant countries in the IMF and that would be the European Union and the United States. I think, a tricky negotiating point for them will be, how do you get past this impasse.

**Jonathan Michie** Yes. I think it nicely illustrates onto the changing balance of the world economy, over the last 10, 20, 30 years. The IMF still reflects the post 2nd World War settlement really, when the United States was the dominant world economy and really insisted on having the main say in the IMF and the World Bank.

Of course, since then that situation has changed. It was rather ironic seeing the Chinese Prime Minister quoted recently as basically warning America that they would have to get their economic house in order, domestically because China was holding all these American Government Bonds and China didn't want to see their investments risked and I thought that nicely illustrated the point.

In terms of the IMF there are really two things, one is that – yes you are right – the changed balance of economic power across the world really has to be recognised. But of course the IMF has had a bad press in the past because of their conditionality of basically, requiring governments to cut government spending in order to qualify for loans, which of course is the exact opposite of what's needed and at the moment.

It ties in to another debate, I imagine will emerge in the G20 about this. The question about, to what extent can the leading economies co-ordinate any fiscal [[reflation 0:06:23]], fiscal stimulus. But on the point of regulation and the differences between America and Europe, I thought Private Eye captured nicely in a report when Gordon Brown visited the States, Gordon Brown was saying to Barak Obama can you save me? And Barak Obama was saying No we can't.

Because it is clear that there is an attitude towards regulation which is interesting, and I think perhaps reflects the fact that America actually, perhaps slightly ironically, has maybe had more regulation on the economy since the 2nd World War during the 1950s, 1960s and so on because they never had much public ownership. In Britain and Europe all the basic utilities – gas, electricity, I think telecoms, railways, coal – was all in public ownership.

Whereas in the United States, because those basic utilities were in private ownership they had to be regulated so you always had more regulation in America. Then you had decades of regulatory

capture where the regulators seemed to really, do what the big companies want, which isn't necessarily the result of corruption.

It can be very sophisticated game playing by the companies to take action on investments and so on, which they guess will bring about the sort of decisions by the regulators which they secretly wanted and so on. It all does get very complex and I sometimes wonder whether that is actually why America is, maybe at the moment, a bit more sceptical about regulation because they have seen a lot of regulation over the years and decades and it hasn't always had a particularly positive impact.

**Linda Yueh** They are, despite America's reservations, I think there is a growing recognition that if capital markets move across borders, you have to have some degree of governance over those capital flows (whether it is an actual regulator or something else).

One thing which they did agree on, which was to expand the membership of the Financial Stability Forum, the FSF which is within the Bank for International Settlements, which is known as the Central Bank Central Bank, because that's where all the Central Bankers gather. But the FSF was set up after the Asian financial crisis in order to set up things like capital adequacy ratios for banks to try and govern the standards by which the capital markets are looked at by individual countries.

And the membership of this body is now going to include the members of the G20 and that is certainly an improvement because they have now captured around 90% of the world's GDP and that's a huge improvement over what it was before.

That being said, all the other regulatory suggestions by Gordon Brown and others there really wasn't much progress at all at this meeting, so there have been ideas floated like, having the Bank for International Settlements play a bigger role in watching for developing global imbalances in asset bubbles [0:09:22]. Having that authority to monitor cross border capital flows so that you have a better sense of where hot money - which is one of the problems in this financial crisis - is coming from and where it's going to.

But, I think when you get to that level of detail and who's actually going to do the monitoring and what it means if they do monitor, I think that's where the negotiations get very tricky. So even in principle, everyone can see that with global capital markets you have to have some degree of oversight, but who runs the oversight or what kind of oversight are the unsettled questions.

**Jonathan Michie** Yes and I think that is a very important point which is maybe one of the few positive things definitely emerging. That people do realise that a completely regulated international free for all in financial markets isn't sensible. I think it wasn't really discussed very much over the last 20 years because the global economy seemed to be doing okay, but it is important to remember that during the whole era when the world economy was actually at its most successful - during the 1950s, 1960s, early 70s - there was actually very tight regulation on financial movements, for purely speculative purposes.

You know, it was always relatively easy to get currency to import and export and invest overseas and so on, but just speculative flows, it was easy to get the foreign currency for. That deregulation only actually happened in 1980. Britain was at the... Margaret Thatcher being in from 1979, abolished the exchange controls immediately with most of the other European countries it was later, in the 1980s.

The assumption at the time, which isn't really remembered much, as that it would be a one off movement and it was a like a dam which was holding back the water and just a market imperfection removed the dam and everything let out. And then, again, one majority would request a foreign currency and would be, again, for exporting and importing, foreign holidays, investment abroad and so on.

But that turned out not to be the case or just big movement in foreign currency which people thought was a one off movement but that actually just continued year after year after year and in

anything, it got bigger and bigger and bigger and now we can see actually, it was just a speculative bubble building up over 20 years.

So I think that is something that has come out of the current discussions which is positive and, I think actually links into economic theory discussions that economists have. Whether the extent of which our text book model has actually reflect what happens in the world or just an abstract way of thinking. For the following reason, that actually Tobin, Nobel Prize winning economist, suggested some time ago, having what became known as the Tobin Tax - he didn't call it that but people called it after him – to tax these international currency movements, which would raise a lot of money and be proposed as an important fund for anti-poverty work globally.

But what's interesting about the tax as far as Tobin was concerned was that it was precisely to determine the world currency markets working like a text book free market, his point was precisely to put, what he called, sand in the wheels, to slow the whole movement down. Because the ultimate aim wasn't just to map the perfect markets for the sake of it, but actually to focus on the real economic processes of investing overseas, importing and exporting goods and services and so on and that could actually be distorted by these purely speculative flows which can slop around the global economy massively disrupting economic currency movements and so on.

**Linda Yueh** Yes. I think we certainly are revisiting that debate. I think one of the biggest parts about this whole G20 is actually what it highlights is that we don't actually don't have a governing system, whether it's for regulating capital flows or investment. There is such a rudimentary system in place and there is quite a lot of infrastructure which is lacking at this international level.

If we think about which exists, there is the WTO, the IMF, the World Bank, the Bank for International Settlements. But actually, aside from trade there is very little cross boarder governance and everything else which exists are voluntary standards.

I think in this crisis, we saw how that meant there is a gap in terms of how markets are operating across boarders creating upheavals within domestic economies, which is in a sense exploiting the fact that there is no super national structure in place. But I do think that having this structure in place will be extremely difficult.

I think that one of the things that the last Washington Summit, which was the precursor to the G20 coming up, was ambitiously called 'Creating a New [[Bretton 0:14:28]] Woods'. I think this is very much on the agenda.

The other big thing on the agenda - which of course they have made very little progress on - was actually how we get out of this current crisis. We heard various things coming out of the major economies,

Timothy Gardner – the US Treasury Secretary – wanted all countries to spend 2% of GDP to stimulate the economy. This did not go down very well with the continental Europeans who thought that a 2% increase and discretionary spending was simply too much debt to take on when, in their economies, there are a lot more automatic stabilisers so their fiscal policy works much more automatically to increase during a recession. Meaning they need to borrow less to spend on discretionary spending because there is a bigger welfare state.

And in fact, the IMF system is that over the next 2 years Germany's fiscal policy it's stimulative spending, looking at discretionary and the automatic stabilisers will exceed 4% of GDP. That's actually more than what the Americans are spending at the moment.

There was that conflict and there was certainly also another area where we didn't see very much pronouncement at all which was this idea that Gordon Brown has of co-ordinating stimulative policies across borders because it is quite true that when you stimulate your economy by cutting taxes or giving tax credits, part of it goes to imports which are another country's exports. If all countries were to do it at around the same time, you'd boost each other's exports giving you a much bigger bang for your fiscal spending than otherwise.

But of all the statements coming out of this meeting, it was remarkably quiet on that point. I suspect it's because budgets and spending are dictated by domestic political agenda and it comes out at certain times of the year for most countries. And this idea of co-ordination just really didn't get off the ground very much.

**Jonathan Michie** Yes, I think your two points are both very important but interlinked aren't they, in terms of the lack of global institutions on the one hand and the need for co-ordinated fiscal effort on the other. Because one thing which might come out of the current discussions on the state of the world economy is the importance of both types of institutions and regulations. A) at a global level, which is absolutely necessary and b) at a nation state level with co-ordination between countries.

I think both are vital and it is important to appreciate that and not allow politicians, sloppy thinking or anything else to get in the way of that and not allow anyone to use one against the other and say, "Well we don't need international regulation because governments can look after their own countries."

Or the opposite which is there's a danger they can say we are now a globalised world, nation states are irrelevant and there's nothing we can do because that's very dangerous and results in people not doing things because then we are in a mess.

The fact is that nation states governments are still the most powerful force and it is therefore vital that they do co-ordinate. And the point about the importance of fiscal policy being co-ordinated across countries is a very important one and actually hasn't, as far as I've seen, really linked into the debate about protectionism, where everyone seems very clear that we mustn't have protectionism as a bad thing.

And yet the realisation that in a very real sense that the fiscal policy that your government pursues can have just the same effect, can be illustrated either way. So the reason they came up with Barak Obama because he wanted to expand his economy, as I say, to be fair to him, if no one else did, then all those [ [?? 0:18:31] ] would have gone overseas and would have had no effect. That was the idea that some of this public money being spent domestically.

But conversely, if everyone else had expanded and just one country decides to, in effect, free ride and do nothing and at the end be able to send all these good abroad then that's equally bad.

And things have long been recognised, going back to the 1930s when there was the same debate about protectionism or devaluing prices in the gold standard where the Cambridge economist - a colleague at [ [?? 0:19:05] ], Joan Robinson - argued protectionism may be harmful but actually being in recession was equally harmful to your neighbouring economies. Because if your country is in recession then you are not buying goods from your neighbouring countries and that is equally a bad neighbourly economy. She had some quote like that, actually keeping your country in recession when there is no need to is the worst of all bad neighbourly policies.

So, I think you are absolutely right, it is key to get that co-ordinated action. The extent to which that will actually come out of the G20 will be interesting.

**Linda Yueh** At the very least, they could have vowed not to be protectionist and you get the sense that that's there. What you say is absolutely spot on in that the other side of this is that countries could agree not to close their borders, whether it is on trade or financial nationalism. This was said at the first summit in Washington last autumn but of course since then, we have seen things like the bi-American Provision in America. And there have been little signs of counties rescuing their banking system and then suggesting they use the money helping domestic firms and domestic home owners.

Now there is nothing fundamentally wrong with that if your firms are suffering from the credit crunch but if, by implication the very same banks you are encouraging, have to pull back from overseas markets to secure their balance sheets, then you are contributing to this idea of

protectionism. When global capital flows are predicted to decline dramatically down to maybe just one hundred million dollars or so, down from over a trillion dollars over the last few years and that is a reaction to the fact that quite a lot of banks are going back to their markets, some because of the subsidies given to them by government.

So I think that financial protectionism hasn't been on the agenda when it really should be and, in many ways, this crisis that's the area that is supremely important. And of course, generally speaking protectionism is just not going to help anyone at all. In fact, the bi-American Provision was watered down in the Senate but just the fact that it was there, and there were little signs of protectionism around the world, like in Venezuela and other places, closing your border off to exports at a time when your economy needs another sector to help propel it whether it needs affect its exports or global capital flows it's just not a sensible policy. But at least I think that is much more recognised than what is happening in the financial markets.

**Jonathan Michie** Yes, I suppose that the one other area where it seems like there is beginning to be more G20 countries, certainly since the first of these discussions that we had. I remember one of the previous ones that we had was that Barak Obama had called for a clamp down on tax avoidance internationally, and I remember saying this, that the British government had not joined in with that and it really does seem to be moving now from Gordon Brown and most European governments as well, to the extent that even Switzerland is at least saying that, for the first time ever, they'll open their books and allow some transparency about who is holding money in Switzerland.

So there does seem to be some emerging sense that there should be some international action against tax avoidance against the tax havens and there is potential of it spilling over into the whole debate about bonus culture in banks, the excessive bonuses paid for failure. Which, again has been both sides of the Atlantic, and it has been big news in Britain with the large pensions being paid out to failed bankers.

But also Barak Obama's made quite a big deal of that with the AIG insurance company that America bailed out now, apparently, paid \$165million in bonuses creating, I think, 73 millionaires in the department which actually caused all the problem. If those two do come together in the realisation and this excessive inequality and absolutely astronomic salaries for the people at the top on the one hand and, in effect, globally with these tax havens, that may be something which comes out of this global crisis. Because, after all, this degree of inequality that we have seen over the last 10 years is quite unprecedented.

There was nothing like that in the 50s, 60s, 70s or even the 1980s. I think that some reversal of those inequalities ironically will be necessary to pay off these huge debts that the governments have got into with the bank bail-outs, or some progressive taxation. But also may help in tackling one of the causes of the crisis.

Because there was a very interesting inaugural lecture given by Professor [ [?? 0:24:15] ] Andrew last week. In which he pointed out that not all consensus has been blamed on the supply side, if you like. You know, these bankers were creating all these new fancy products and no-one really looked on the demand side why they were all being bought up, where were was this demand coming from? Part of it was coming from governments and so on.

The big new story in that was - the big new feature in the last few years compared to previous decades was this massive rise in super billionaires, the very high net worth individuals. Who in quantitative terms had represented quite a large slice of this demand for all these new products, financial products.

So actually if that clamp down on tax avoidance and tax evasion globally, along with a more sensible distribution of income within countries and between countries. If that emerges, it would actually help not only to repay over the years, all these huge debts which have been created - these huge debt [ [?? 0:25:23] ] that have been created - but also may help to create a more stable economy here in the future.

**Linda Yueh** I suppose that is a nice entry into our next podcast which will look at the UK budget as it comes out and assess how we've come along on the recession as well as the bail out package. I should hasten to add the reason the budget was moved allegedly, to come out later on in April, was that it could follow the G20 summit.

So a lot of the issues that we have covered today are viewed to be very important to the British government as it creates its budget. And I suspect, it will be very important for a lot of economies as they look to the global economy as a source of context for setting out what they are going to do themselves in the next few months, in the next year.

**Jonathan Michie** Final word I would say, you should note that Mervin King the government back in today was quoted, from a speech yesterday criticising quotes *casino trading* of investment banks which I think is very important because I, along with a lot of other people, have been criticising the whole casino capitalism movement that we have had for the last 10 or 20 years for some time. So it is good to see them coming on board.

**Linda Yueh** It is a nice point to end on.

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