

The Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System

Memo to the Commission on the Design of Stimuli

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1. There is by now a well agreed set of principles which should guide stimulus expenditures:
 - a. Given the magnitude of the national debt, is it especially important that there be a big bang for the buck.
 - b. Given the long delay in undertaking national actions, it is important that the effects are felt quickly
 - c. So far as possible, the expenditures should be consistent with a broader national and global vision, and reflect other priorities:
 - i. Expenditures on high return investments may actually improve the nation's balance sheets
 - ii. Such investments would include those that improve technology, especially of the green kind, and help us adapt to production patterns that reflect greater environmental sensitivities.
 - iii. Expenditures that reduce the increasing inequality gap would fall within this category.
 - d. There are some obvious examples of programs that fall outside these guidelines
 - i. Programs that increase America's already high consumption would not satisfy this criterion
 - ii. Tax cuts for upper income Americans are likely to have little bang for the buck and, to the extent that they are effective, increase America's already high level of consumption and inequality.
 - e. In implementing these guidelines, there may be trade-offs, with some measures that more directly meet long term national needs having less of a bang for a buck, or taking longer to implement. In some cases, it may be possible to phase in stimuli, beginning, for instance, with school reconstruction (which can be implemented quickly), and moving on to road construction (which make take a while to plan).

2. It may be useful to think of the stimulus program as consisting of several parts:
 - a. Preventing the downturn from getting worse
 - b. Protecting those hurt by the downturn
 - c. Accelerating the recovery
 - d. Providing the basis for sustained growth

3. In many economies there are built-in destabilizers. State and local governments will have to contract expenditures unless the Federal government meets their shortfall in revenues. These expenditures should be given the highest priority. Failure to do so will mean that the downturn will get worse.
4. Measures to protect those hurt by the downturn may also have large multipliers. Those receiving extended unemployment insurance are likely to spend it.
 - a. In countries with weak social safety nets, it will be especially important to expand social protections, for instance, providing health insurance or assisting families who might otherwise face foreclosure.
5. One of the reasons for the current problem was an excess of liquidity; but one of the reasons that Central Banks provided these excessive amounts of liquidity was that it was necessary to do so to maintain a strong global economy. In the absence of such support, there might have been an insufficiency of American and global aggregate demand. This problem of insufficiency of aggregate demand has to be addressed if there is to be sustained growth. We face a *global* economic crisis, which requires stimulation of global aggregate demand.
6. Increased inequality within most countries of the world and excessive reserve accumulation by some developing countries contributed to the current problems of insufficiency of global aggregate demand. Policies promoting greater equality would thus promote global equity and strengthen global growth.
7. The problem of excessive reserve accumulation can only be addressed by moving to an alternative global reserve system and by providing better instruments for risk sharing, especially between developed and developing countries.
 - a. Moving from the dollar reserve system to a dollar/euro reserve system may make matters worse, increasing global instability.
 - b. This is an opportune time to expand nascent efforts at creating a more multilateral reserve system.
 - i. Such efforts could build on the existing system of SDR's, the Chiang Mai initiative, and other efforts at sharing of reserves and swaps
 - ii. While it would be desirable to have a one-time issue of SDR's, this will not address the underlying structural problem. There needs to be an annual emission of a global reserve currency.
 - iii. Surplus countries are as much, or more, part of the problem as deficit countries: the sum of the world's trade deficits is simply equal to the sum of the world's surpluses. Countries that consistently maintain trade surpluses exert a negative externality on others. Reducing allotments of new global reserve emissions to surplus countries might provide an effective incentive to reduce surpluses
 - c. While there have been improvements in capital markets in recent years, developing countries still bear a disproportionate share of the risk of exchange rate and interest rate volatility—in spite of the fact that efficient capital markets would transfer the burden of such risk to developed countries, who are in a better position to bear the burden

- i. This entails further development of bond markets in local currencies. Members of the Commission may want to discuss alternative mechanisms by which this might be done
 - ii. It also may entail the development of innovative risk-management products by the International Financial Institutions
 - d. There should be improvements in the way the international community handles the consequences of shocks to developing countries that are beyond their normal ability to bear
 - i. This is especially the case when (as today) those shocks emanate from outside the affected country
 - ii. While it is natural that those providing funds want to be sure that those funds are well spent, so that the likelihood of repayment is increased, conditionalities have often gone far further
 - 1. Ironically, it is now recognized that in some cases, the IMF encouraged deregulation measures that enhanced the risk of instability and crises
 - 2. Fear of loss of (economic) sovereignty provides a strong motivation for countries to maintain excess reserves
 - iii. Most countries have bankruptcy laws that allow an individual facing excessive debt burdens to get a fresh start. Yet, we still do not have a sovereign debt restructuring mechanism that allows this to be done efficiently and fairly, in the case of poor countries that face debt burdens beyond their ability to pay.
 - 1. This problem may become especially important as the world sinks further into a global downturn
 - 2. The imperative to address these issues is especially important in the context of odious debts
 - iv. All countries, but especially developing countries, need flexibility in finding the appropriate responses to this crisis and other crises which they may face in the future.
 - 1. Current international agreements may limit the scope for such responses. Indeed, some argue that some responses (undertaken, or proposed) by developed countries may violate existent trade agreements, including the Financial Services Agreement. But as noted below, enforcement of such agreements is asymmetric.
 - 2. Bilateral and multilateral investment agreements may further limit the scope of action in responding to crises, evidenced by suits undertaken in response to the 1997 East Asian crisis and the 2001 Argentinean crisis.
 - a. In light of this, key terms in these agreements may need to be renegotiated.
8. Without assistance, developing countries may have limited ability to engage in countercyclical stimulation. But a global economy in which developed countries engage in countercyclical policies and developing countries are forced to engage in pro-cyclical policies will lead to global imbalances and instability and will

adversely affect growth and poverty reduction in developing countries. It is imperative, therefore, that the international community provide developing countries with additional support so that they can pursue countercyclical fiscal policies.

9. Some will worry about the long term consequences of the increased national debt as a result of fiscal stimulus.
 - a. As noted, the size of the debts of many countries makes it especially imperative that stimuli packages be well designed.
 - b. Developed countries should be aware that funds are limited, and funds used to promote growth in developed countries may reduce the magnitude of funds available to support development in poorer countries.
 - c. They need to be particularly mindful that bail-outs of firms and sectors within their own countries may not constitute effective stimuli and give those firms and sectors a distinct competitive advantage over those in developing countries. Most developing countries cannot compete in the provision of these subsidies, which represent a major distortion of markets. The developed countries are in the process of creating an even more unlevel playing field. For years, product and financial markets will be distorted as a result of these government interventions in market processes; they will not be easily undone. Even the knowledge that failure may be rewarded with a bail-out allows firms in developed countries to undertake greater risks, and thus the legacy of these bail-outs will last years into the future.
 - i. International trade agreements provide an inadequate framework for responding to these inequities. Even when developed countries are found to be in violation of international trade agreements, there may be no effective sanctions that a developing country can bring. The current system is inherently asymmetric. Moreover, the length of time for adjudicating these disputes is sufficiently great that, even were an effective sanction available, firms in developing countries could face bankruptcy. There are important hysteresis effects, especially important given the inherent scarcities of capital and entrepreneurship.
 - d. For most countries, anxieties about future tax burdens as a result of increased deficits are not likely to be sufficiently great to offset the stimulative effects of increased government expenditures. Few econometric studies lend substance to such concerns.
 - i. This is especially the case for expenditures on investment, which strengthen a nation's balance sheet. Enhanced prospects of future well-being may actually lead to increased current levels of consumption.
 - ii. But such concerns may help explain why tax cuts for upper income individuals often have limited stimulative effects
 - iii. Such concerns reinforce the importance of designing programs with intertemporal substitution effects, e.g. temporary investment tax credits

- iv. And such concerns reinforce the importance of designing programs that address market distortions, e.g. enhanced availability of credit for small and medium sized enterprises
- 10. The need for taking countercyclical discretionary policies will be greater in countries with weaker automatic stabilizers (stronger automatic destabilizers). Some countries have weakened their automatic stabilizers in recent years, and this may be an opportune time to reconstruct automatic stabilizers, especially those associated with addressing problems of growing inequality.
- 11. The focus on short term stimuli should not divert the international community's attention to persistent long run problems, including poverty alleviation (the achievement of the Millennium Development Goals) and addressing global warming. Indeed, as we recognize the need for a *global* stimulus, this may provide an opportune time to increased expenditures directed at these global problems.