

**NTU-CSC Panel Session on
“Prospects and Challenges after the Global Crisis”
5 August 2009, 3.45 pm, Civil Service College Auditorium**

Chair:

Lim Chong Yah, Professor of Economics, Nanyang Technological University

Panelists:

Pranab Bardhan, Professor of Economics, University of California at Berkeley
Wing Thye Woo, Professor of Economics, University of California at Davis
Steven Sheffrin, Professor of Economics, University of California at Davis

Discussants:

Tan Kong Yam, Professor of Economics, Nanyang Technological University
Joergen Oerstroem Moeller, Visiting Senior Research Fellow, Institute of
Southeast Asian Studies (ISEAS)

Professor Pranab Bardhan, Prospects and Challenges for India

Professor Bardhan opened the session with the observation that compared with many other countries, India had been relatively unaffected by the global crisis.

First, the banking sector in India had been largely insulated from the crisis, and the banks were well-capitalised and reasonably well-regulated.

Second, exports and foreign direct investment (FDI) both made up a relatively small proportion of India's gross domestic product (GDP), compared with other emerging economies like China.

Third, a large proportion of the Indian economy, some 85% of the non-farm workforce and 45% of non-farm GDP, lay outside the formal sector. The informal sector had been relatively, though not fully, insulated from the crisis.

India was not entirely unaffected by the crisis. When liquidity dried up in foreign capital markets, Indian multinational companies (MNCs) that had been borrowing in foreign markets came back home, creating liquidity stress in the Indian capital markets. Reduced portfolio investment in India as a result of the global crisis led to lower net capital inflows and added greater liquidity stress. Fortunately, the Reserve Bank of India was able to act quickly to prevent an insolvency crisis.

However, Professor Bardhan noted that India was more constrained in its fiscal policy responses by its high fiscal deficit, which, after the stimulus package announced by the government, was around 12% of GDP. The two major obstacles to development in India, in Professor Bardhan's view, were weak physical infrastructure and weak delivery mechanisms for social services for the

poor (such as health, education and so on). Solving these problems will require not just greater government investment, which is hampered by India's fiscal position, but higher standards of governance as well.

Professor Woo Wing Thye, "China: Prospects and Challenges after the Global Crisis"

Professor Woo discussed three risks for China after the crisis: the possibility of hardware failure, software failure, and a power supply failure.

Hardware failure referred to the failure of infrastructure, institutions and policies, such as the failure of the banking sector or the pension system. Of the three categories of failure, hardware problems were the easiest to resolve, as they were susceptible to technical solutions, and China could consult other experts and countries on possible solutions and strategies. China's strategy of export-led industrialisation, for example, was neither new nor unique to China.

Software failure referred to the breakdown of social cohesion and national identity, as well as failures of governance. Professor Woo saw risks of software failure in the growing number of mass incidents and social unrest in the last 15 years or so in China. These incidents were partly a consequence of administrative failure at local government levels, and partly of rising expectations on the part of the public – the level of governance and the standard of living had risen in absolute terms over the years, but perhaps not as quickly as expectations had. The biggest software failure in China, in Professor Woo's opinion, was the weakening of trickle-down mechanisms. The overall rate of poverty had fallen, but extreme poverty, defined as US\$0.50 a day, had become entrenched in China. This was a symptom of the worsening income distribution. When added to problems of local governance, the situation was potentially explosive. What was needed were not just more jobs but more assistance to help people build up their human capital for the available jobs – additional trickle-down mechanisms such as greater investment in rural health and in local universities, and more rapid urbanisation, as well as greater accountability on the part of local government.

Power supply failure referred to external concerns, such as world trade and the threat of protectionism, and what to do about climate change. The atmosphere in the West was ripe for protectionism, with talk of renminbi (RMB) appreciation in the US, and growing tolerance for trade adjustment and correspondingly less popular support for free trade. (Free trade and technological innovation had created tensions in the US labour market and social security system, which had not evolved to cope with increased job churning.) On the environmental front, China was the world's largest emitter of carbon dioxide, with the dirtiest air in the world and a growing problem of water shortage. Protectionism might start in the guise of climate change. Of the three categories of problems, power supply

failures were the most difficult to deal as they depended on external forces and could not be easily controlled by China.

Professor Steven Sheffrin, “The U.S. Economy at a Crossroads”

Professor Sheffrin highlighted three risks for the US economy post-crisis. The first risk was that of fiscal instability. The Congressional Budget Office had warned in July 2009 that the federal budget deficit was unsustainable, meaning that it was likely to grow faster than GDP in the long run. The current deficit was 12% of GDP; the last time it was as high a proportion of GDP was during the World War II.

The second risk was of monetary overhang. There had been a vast expansion in the assets of the US Federal Reserve as a result of its actions, and the Fed had pumped roughly \$1.3 trillion into the economy. Banks were currently holding vast excess reserves without making loans. The concern was when banks would start lending and if the consequent expansion of credit would lead to higher inflation. When the Fed expanded the money supply, they did so by buying large amounts of assets in troubled markets, such as mortgage bonds, asset-backed bonds and commercial paper. It was an open question whether such actions could be unwound, and whether the Fed would be able to retain its political independence to unwind its purchases and allow interest rates to rise and spreads to widen, actions that would be unpopular in Congress and the public.

The third risk was dollar fatigue. The current crisis was not the crisis that economists had been predicting for the last 15 years or so, which was a dollar crisis – that the world would stop finance US consumption, resulting in a capital flight from the dollar, the depreciation of the dollar, higher interest rates, and a worldwide recession. What happened instead in this crisis was that there was a flight to the dollar and the appreciation of the dollar. The savings-investment imbalances between the US and China that prompted concerns of the first crisis, the dollar crisis, were still with us. Although US household savings had increased, the increase might be offset by additional dis-saving by the US government. However, there were some hopeful signs in the greater focus in China on their social safety net and the possibility of an orderly dollar decline.

The biggest risk, in Professor Sheffrin’s opinion, was not an economic risk, as the US economy had demonstrated its resilience time and time again. The biggest risk was populism, in the form of anti-tax sentiment that made the fiscal deficit more difficult to reduce, pressures for a politicized monetary policy, and calls for protectionism in relation to job growth and possibly climate change.

Discussion

Professor Tan Kong Yam, the first discussant, offered three points on China, the US-China relationship, and implications for the international monetary system.

First, the fiscal and monetary stimulus introduced by the Chinese government had led to a V-shaped recovery in China. This might encourage the Chinese and other countries around the region to conclude that there were advantages to a more centralized system of government (as compared to the systems in the West), especially in combating a crisis.

Second, Professor Tan predicted that China would diversify its assets with a drive towards global resource acquisition. Some 64% of Chinese reserve holdings were currently denominated in USD. On the other hand, China's share in total global FDI was low, compared to developed economies such as the US and Japan, and its resource endowment poor compared to its consumption in per capita terms.

Third, the global crisis had strengthened the impetus to turn the RMB into an international hard currency, and it was likely that China would take steps to promote the RMB in trade, develop its domestic capital markets, and gradually allow capital account opening and convertibility. In the long term, East Asia could become an RMB zone.

Professor Joergen Oerstroem Moeller, the second discussant, shared five observations on the global crisis with the audience. First, the main problem of the global crisis was that global demand and global supply were out of sync and needed to be rebalanced. This was a difficult process, and subject to two major deficiencies with the decision-making process: that people did not react as expected – the US consumer, for example, had started to save at entirely the wrong time for the global economy; and because the global economy was affected by national policies and national priorities. Because any national stimulus package was likely to have an effect on other countries, governments were watching one another, with no-one willing to make the first move.

Second, the link between what made it profitable for corporate and financial institutions, and what made it profitable for the global economy as a whole, had been broken, and had to be repaired for the global financial system to work again.

The third was the high risk of protectionism, especially in the global investment sector.

The fourth was the prospects for the US dollar. Problems for the dollar would start when people around the world ceased to trust that the US government would tax its citizens to service its debt. However, there was at the moment no real alternative to the dollar.

Last and thorniest was the global environment. Tackling climate change was a question of burden-sharing, and the process of establishing who pays for what was likely to be agonizing and acrimonious.