

**Statement by Supachai Panitchpakdi,
Secretary-General of UNCTAD,
to the consultations of the President of the Trade and Development Board**

Geneva, 16 October 2008

Thank you very much, Mr. President.

Allow me to preface my statement this morning with a somewhat lengthy introduction. Having been so personally involved with the Asian financial crisis 11 years ago, I feel there were many lessons that we could have learned from but that we missed out on, and every day now the financial papers are writing about the things that countries are trying to introduce, as if they were re-inventing the wheel. But all of these processes, collapses, and rescue operations – we have been there before.

I fully support you, Mr. President, in your efforts to enhance communications with all member States through your consultations. It is a pleasure and an honour for us to be discussing this highly intractable issue with you. This latest financial crisis will engulf us all in a process of unwinding with probably damaging results. We therefore have to see to it that the rescue operations leave nothing to doubt, that they do not impinge on the kinds of solutions we may need for other crises, and that they do not lead to other problems of the kind we have seen in Asia.

Mr. Flassbeck will be more technical in his presentation, and so I would like to show just one slide: a cartoon I picked up from *Le Temps*, which was reprinted in the *International Herald Tribune*. As you know, Paul Krugman received the Nobel Prize in economics a few days ago, but the cartoon says that the Nobel goes to Mr. Jones for keeping his savings at home. I find this an excellent reflection of our times. The decision to be careful about how we manage our banks is so crucial. These days, people are withdrawing their deposits from private banks. Only when bank deposits are owned or guaranteed by the State can you get people to leave their deposits in the banks. This is really a new era, and it is quite indicative of how we are going to treat the issue, because I don't think the whole world can go on a spree of nationalizing all the banks in order to maintain depositors' confidence.

Let me go back to the Asian crisis of 1997, 1998 and 1999, when I was brought on to the rescue team. We kept explaining at the time that it was a systemic crisis that could recur, because the system itself has inherent defects. With all the world focused on Asia, saying that this was typical Asian negligence, cronyism, mismanagement and corruption, I wrote several papers on the subject. I said that yes, we may have been lured into complacency by the long boom of the 1990s, and that we had now been caught by the banks that lent to us. Mark Twain said that a banker was a fellow who gives you his umbrella when the sun is shining, but the minute it rains, he wants it back. This is speculation, and what killed us in Asia back then was this taking the umbrella back at the time of the crisis. The lack of oversight, the greed, the real estate boom – we saw it all happen before, in 1997, 1998 and 1999.

People have been warning about imbalances, speculation in the exchange rate, the housing bubble, all of which are ingredients for disasters just waiting to happen. I think economics might have been wrong on many points, but ultimately, economics will be right; it is just a matter of timing. And the lesson we learned in Asia is that the

longer you wait, the longer you tolerate the imbalances and lack of oversight, the harder you will be hit. How can you take away the food and drinks when people are enjoying the party and everything is going so well? This kind of boom-and-bust economic cycle will stay with us; but this particular boom-and-bust is the "mother of all boom-and-busts", and will require the "mother of all solutions".

The whole situation has of course been exacerbated by the fast pace of deregulation in the system. Before the Asian bust, it was recommended that Asian economies completely liberalize their capital accounts, but they failed to prepare well for this – which is also what happened over the past decade. We have seen unprecedented deregulation and liberalization in the financial sectors, accompanied by great inventiveness of bankers, who have come up with all kinds of new products, including derivatives, securitizations, swaps, and so forth, all of which diverted attention from the clarity, transparency and quality of loans. So the more we liberalize, the less we have oversight, and the less we understand what is happening to the banks, because everything is kept off the books. And when all these securitized loans are sold from one bank to another, from the United States to Asia or Europe, for example, at the end of the line nobody cares; you buy a name, you buy the bonds, you buy the papers. This is what happened with the subprime mortgage market in the United States – people borrowed without their income being checked – and then of course the market was backed up by the big mortgage institutions like Freddy Mac and Fannie Mae.

UNCTAD has been warning about all this for years. The *Trade and Development Report 2007* had a chapter on global economic and financial conditions that dealt with global imbalances, stability and speculation. It said [p. 18]: “It has been debated as to whether the speculative run on the [Icelandic] krona was triggered by the perceived non-sustainability of the huge current account deficit.” Is this foresight? Hindsight? This is exactly what is happening today, and there will be more economies hit by the non-sustainability of huge current account deficits.

In my report to UNCTAD XII, there is a chapter on coherence in global policymaking, which we discussed at length in Accra. Allow me to quote just one sentence [p. 21] to show we were mindful of these risks long before the current crisis erupted: “To avoid a fight for market shares through manipulation of the exchange rates, which raise taxes and subsidies, and to prevent the financial markets from driving the competitive decisions of nations in the wrong direction, a new code of conduct is needed regarding the overall competitiveness of nations”. Today you hear nothing but talk about codes of conduct, new rules, new Bretton Wood agreements – but again, we have been there before. We have warned the world – but while many people have been oblivious, we have not; the only problem is that we have not been read widely enough.

After the arduous negotiations on the Accra Accord, you gave us the following mandate: “Identifying specific needs and measures arising from the interdependence between trade, finance, investment, technology and macroeconomic policies from the point of view of its effect on development”. And this is what we are trying to do today, on your behalf. We have not been asleep on the watch, like some global financial institutions; we have warned the world, and talked for year after year, about the need to address the lack of regulatory oversight of the financial system, especially given that the multilateral trading system has long been subject to such oversight.

What do we do next? As the President has asked, what is the short-term response, and what the long-term response? Is this just the tip of the iceberg? Let me explain why it will not go away quickly. The Asian crisis was followed in 1999-2000 by

a peak of investment in the IT industries, which helped the Asian economies return to some normalcy. Although there was a slight setback in IT after that, Asia was again helped by the Y2K boom. Now as then, we must go through the unwinding process, shedding excesses. Allow me to put it on a more personal level: If you have spent 10 years eating everything the doctor told you to avoid, and you have just 10 days to slim down, it is simply not possible. You kill yourself; or you kill the global economy.

The unwinding of the financial excesses – whether it be excessive borrowings, risk-taking, innovation or exuberance – will involve four major processes, and they also cannot be undertaken overnight. The first is to allow all inflated asset prices to fall to a sustainable level. The Asian economies were told to do fire sales, to keep the so-called distressed assets off the books – in short, to kill off the entire economy, which was disastrous. This is not to be repeated, of course, but it does raise a question that must be put to policymakers worldwide: Do we allow inflated prices to drop gradually, or quickly – the faster the better? Allowing inflated asset prices to reach bottom could ruin the whole global economy. But housing prices are not anywhere near the bottom in the U.S. and Europe, so there is still a long way to go before we reach a sustainable level. You don't have buyers; you don't have builders; you have people who want to get out of the market.

The second process we need is a de-leveraging of the private sector – giving back loans, and returning to normal consumption patterns. I am not just talking about the banking system; the entire private sector has been leveraging, and irresponsibly. The word 'greed' has been used a lot in the past few weeks – basically unlimited greed. Can we de-leverage in time? Now the authorities are offering to come in and help, to provide new liquidity and buy up distressed assets: yet another unwinding.

And the third process is to determine all the losses. But how? Can governments bear all the losses? So far, this has been just a band-aid operation, but one that is costing the world at least \$2 trillion, and that is only a modest estimate; the realization of financial losses will be tremendous. So how are we going to account for all these losses? The implications will be huge for everything we are doing at the UN – including the FfD process, which will have to be reviewed in the light of what is happening now.

The last process is to recapitalize the financial system – to inject new equity into it. The system cannot operate without this. After restoring liquidity in the first of these four processes, there will be no capital left to lend, so the system will have to be recapitalized. But once the band-aid job is finished, then comes the real surgery – and this has not yet begun. I do not say this to frighten you, but this is a long-term process. We went through it in Asia, and we have much to learn from the Asian experience on how to avoid some of the pitfalls.

Now let me also emphasize the following: All these processes cannot take place if we leave them to the markets alone; that would be totally disastrous, because the market cannot resolve everything in an absolutely abnormal situation.

Again, UNCTAD has been saying this all along, and not just with hindsight; we said so most recently in the policy brief we issued the other day, and I quote: “In a time of uniform expectations, the market cannot find the bottom without countercyclical government intervention”. This is what happens in times of fear, and with the kind of herding instinct and behaviour that frequently characterizes the financial system. People do what their neighbours do; no rationalizing. What this calls for – and again, as

UNCTAD has so often recommended – is revisiting the role of the State; prudential regulations; and regulatory oversight.

Just a few comments on the short-run impact, particularly on the "innocent bystanders": First, I think no one would disagree that the impact on recession will be much, much deeper than anticipated. During the Asian crisis, we were told to do "overkill"; you do not know what is enough to correct the issue, so you do overkill. If you need a billion, you put in 10 billion, and then you have to stem the tide of recession. I do not know whether we have the capacity now to mobilize the amount of overkill that would stem the tide of recession, but there is no doubt that the real sectors are beginning to suffer, and this is just the beginning. As time goes by, all real sectors will be affected, so more and more needs to be done on a global, concerted basis to prevent the serious downturn recession from becoming even deeper.

Second, on the trade side, real impacts will come not only from the economic recession or downturn but also from the ongoing volatility in exchange rates. There will be more speculation, which will only fuel more movement in exchange rates. Exchange rates are now so high in many countries that as they unwind, trade will suffer.

My third comment concerns the commodity boom of the past seven years, which is now coming to an end. This is good news for consumer countries that import the commodities, and bad news for the exporting countries. Countries in Africa, for example, that have enjoyed the boom will now have to face up to some tough times. As to the impact on the stock market, which has become an indicator of success or failure, I do not think we can rely on it much, as there is so much gyrations these days that people are just walking away from the banking system – walking away from anything, in fact, that involves putting their cash into something over which they have no control, and that includes speculation on the stock market. They would rather hang on to their cash; cash is now king. UNCTAD has continually asserted that speculation was the major culprit in the food and energy crises and in exchange rate fluctuations, and now this will have to be dealt with.

This brings me to four questions that we must sort out, together. First: The rescue operations, unwinding processes, and need to recapitalize will suck in liquidity from markets all around the world. Will there be anything left for other global efforts, including ODA, climate change adaptation funds, the MDGs? The implications are tremendous. Where will we find the trillions after trillions that are needed? The rescue operation is currently limited to the financial system; but more rescue operations will be needed for the real sector.

My second question is: Given that all the major banks worldwide are undergoing some sort of nationalization, what will be the secondary effects on private banks? Will the fight for funds be equal between giant State-backed or State-owned financial institutions and small private institutions? Of course not. So where will the funds go? They will not go to emerging economies, precisely because they *are* emerging economies, and also because the banks there are probably owned primarily by the private sector. The funding base of emerging economies today comes from the stock market and the financial system, but the costs are rising daily. The inter-bank margin on policy rates has never been as wide. It used to be less than 0.01%; now it is 2%, 3% or 4%, which is just killing for the real sector.

The third question concerns what we at UNCTAD have been calling the "capital flow paradox", and our warnings about "carry trade". How can we recreate global

finance in a way that allows more savings on these capital flows from developing countries to be absorbed into productive investment in their respective markets? One of the major causes of the past exuberance, over-expenditure and over-borrowing in advanced economies was the flow of capital away from emerging economies into US Treasury bonds, T-Bills and the like: Consumption in the West has been financed by money from the East. We need some balance. Maybe we cannot increase consumption in Asia at this point, but at least the new global financial system must address the capital flow paradox and keep channelling these flows into productive use in developing countries.

Fourth and last, how can we combine liberalized capital markets with a reasonable degree of financial stability? I do not think this crisis will pose the ideological question as to whether the capitalist market system can continue, because it is still the best system around. We need both the liberalization of capital markets – because this can help people around the world gain access to capital and funds – but at the same time we need financial stability.

I would like to close with a few quotes that I think can guide us in the future. The first is from Professor Jeffrey Garten, whose approach is very much like UNCTAD's. In a *Financial Times* article last April – long before the current meltdown – he wrote: “We are therefore faced with a challenge of massive proportions that will require the re-examination of everything, from how financial institutions of all kinds are overseen globally, to the stability of the international currency regime, to the role of central banks and their relations to one another and to the strengthening of social safety nets”. All these things – social safety nets, central banks, financial institutions – will always be needed.

The other day, the UN Secretary-General said: “At the United Nations we need to consider urgent multilateral action to alleviate the impact of recent events on the development agenda of the organization, covering the entire gamut of issues from the implementation of the Millennium Development Goals to the food and energy crisis as well as the challenges of climate change”. He went on to say how strongly he feels that at our next major conference – the one on Financing for Development, to be held next month in Doha – we must discuss how to sort out all these issues. And I want very much to support him on this.

Next week I will attend the Chief Executives Board meeting with him in New York, and I will be providing him with current and future UNCTAD work for that meeting and for the Doha Review Conference. We at UNCTAD will be setting up our own task force, as we did with the food crisis, which we hope will be plugged into the whole UN system. It is our strong belief that there should not be a "Bretton Woods Two"; no more Bretton Woods. The architecture of the global financial system must be redesigned, but this cannot be done only by the G-8, by those who have just presented us with the mother of all financial crises. Redesigning the architecture of the international financial system must be a global undertaking and a UN initiative.

Thank you very much, Mr. President.

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