

GENERAL DISCUSSION
Asia, the Financial Crisis,
and Global Economic Governance

Chair: Kevin M. Warsh

Mr. Warsh: I think John is available for a couple of questions.

Mr. Hale: As you said in your talk John, the IMF did encourage 9 to 12 months ago that countries should pursue fiscal stimulus to cope with the recession and the financial crisis. The big issue I think now looming over the next two or three years is how we'll disengage from these policies because we do have some very, very large structural deficits out there. The U.K. deficit is 13 percent of GDP and that's without any fiscal stimulus. That's simply because Tony Blair built an economy on asset inflation. The British government had money coming from property tax turnover and from city of London revenues, which have fallen in half this year. The U.S. has a structural deficit. Once we're into a recovery going out three or four years, it looks like it's about 6 percent of GDP, bigger than it was in the Reagan years, which was also thought to be unsustainable. Then you've got a massive deficit in Japan with a new government that wants a lot of new tax cuts and things like that. Their public debt could exceed 200 percent of GDP in two or three years. What can the international community, or the IMF in particular, do to encourage a return to fiscal responsibility?

Mr. Lipsky: As a point of information, it was actually in January 2008 that Dominique Strauss-Kahn stated in Davos that substantial fiscal stimulus was going to be needed to counteract the crisis. And at the Peterson Institute in March 2008, I said that direct budgetary support for financial institutions was going to be necessary to counteract the crisis.

You used the word exit strategies, which is certainly a useful and widely used term. It makes me gun-shy, frankly, because it sounds like there's a light switch and the issue is, when do we turn the switch from on to off. It seems to me that's one of the hopeful signs of the creation of the framework for a strong, sustainable, and balanced growth. In other words, we face a whole myriad of very big challenges of which the removal of policy stimulus and direct discretionary stimulus is but one of many questions, and I think your question refers

to one of the critical challenges, one that we've been trying to call attention to. You'll find this discussed in some detail, for example in the latest *World Economic Outlook*, where we have a rather striking graph that portrays the net present value of the expected fiscal deficits in the leading economies. What it points out is that, even though the anti-crisis efforts are having a substantial impact on the overall debt-to-GDP ratio of the advanced economies, our figure is that, under current programs—in other words assuming that the 2010 discretionary stimulus is actually implemented as planned—the overall debt-to-GDP ratio for the leading G-20 countries is going to go from about 70 percent of GDP to about 100 percent by 2014. Trying to reduce the debt-to-GDP ratio on some plausible time frame, not a quick one, back to just the pre-crisis levels will require quite eye-popping levels of primary surpluses. And this is before you begin to deal with the issue that, according to the promises on the books in advanced economies, the combination of demographics plus plausible assumptions about increases in health-care costs are going to balloon the debt.

As I said, if you look at it in a net present value context, the anti-crisis measures are really a very small part of the fiscal problems that face us over the next couple of decades. As I've told our Fiscal Affairs Department, over the past couple of decades they've gotten used to worries about fiscal problems in developing emerging economies. I think in the next 10 to 15 years we're going to be talking about how to deal with fiscal challenges in the advanced economies. So it seems to me that this is exactly the context in which a collaborative strategy and collaborative approach should be useful. As I said, these are big problems. There's no guarantee they're going to be solved easily. I think it's quite encouraging that in every area so far the political response has been both collaborative and innovative. Now let's see if we can carry it through. It's going to be tough.

Mr. Warsh: One final question for John?

Ms. Mandaro: Today we saw Brazil impose a tax on foreign purchases of fixed income securities. This seems designed to tamper the capital inflows that have been the subject of so much discussion. Are you concerned about more controls like this being introduced? Would this be a bad thing? Can you give me your thoughts on that?

Mr. Lipsky: I'm probably going to disappoint you here. Since I haven't had a chance either to look at those Brazilian measures in detail or consult my colleagues, I don't really have any specific response. But it points out the kind of problems that have been raised by the rebound in capital flows. Obviously

there is a very positive element, a positive message that we've heard about the rebound in asset prices in emerging markets. It was only a few months ago that we were looking at a very severe sudden stop in capital flows to many emerging market economies. That has reversed with a vengeance, as it's been recognized that these economies have shown greater resilience and greater promise than might have been expected even months ago. So this is the good part. The challenges of adequate management are obvious, and again I don't have any particular response to the Brazilian measures.

Mr. Warsh: Thank you very much John.