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The Global Economic Crisis:

Systemic Failures and Multilateral Remedies

Advance copy

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

The Global Economic Crisis: Systemic Failures and Multilateral Remedies

Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation

UNITED NATIONS
New York and Geneva, 2009

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UNCTAD/GDS/2009/1
UNITED NATIONS PUBLICATION
Sales no. E.09.II.D.4
ISBN 978-92-1-112765-2

Key messages

UNCTAD's longstanding call for stronger international monetary and financial governance rings true in today's crisis, which is global and systemic in nature. The crisis dynamics reflect failures in national and international financial deregulation, persistent global imbalances, absence of an international monetary system and deep inconsistencies among global trading, financial and monetary policies.

National and multilateral remedies

- **Market fundamentalist *laissez-faire* of the last 20 years has dramatically failed the test. Financial deregulation created the build-up of huge risky positions whose unwinding has pushed the global economy into a debt deflation that can only be countered by government debt inflation:**
  - *The most important task is to break the spiral of falling asset prices and falling demand and to revive the financial sector's ability to provide credit for productive investment, to stimulate economic growth and to avoid deflation of prices. The key objective of regulatory reform has to be the systematic weeding out of financial sophistication with no social return.*
- **Blind faith in the efficiency of deregulated financial markets and the absence of a cooperative financial and monetary system created an illusion of risk-free profits and licensed profligacy through speculative finance in many areas:**
  - *This systemic failure can only be remedied through comprehensive reform and re-regulation with a vigorous role by Governments working in unison. Contrary to traditional views, Governments are well positioned to judge price movements in those markets that are driven by financial speculation and should not hesitate to intervene whenever major disequilibria loom.*
- **The growing role and weight of large-scale financial investors on commodities futures markets have affected commodity prices and their volatility. Speculative bubbles have emerged for some commodities during the boom and have burst after the sub-prime shock:**
  - *Regulators need access to more comprehensive trading data in order to be able to understand what is moving prices and intervene if certain trades look problematic, while key loopholes in regulation need to be closed to ensure that positions on currently unregulated over-the-counter markets do not lead to "excessive speculation".*
- **The absence of a cooperative international system to manage exchange rate fluctuations has facilitated rampant currency speculation and increased the global imbalances. As in Asia 10 years ago, currency speculation and currency crisis has brought a number of countries to the verge of default and dramatically fuelled the crisis:**
  - *Developing countries should not be subject to a "crisis rating" by the same financial markets which have created their trouble. Multilateral or even global exchange rate arrangements are urgently needed to maintain global stability, to avoid the collapse of the international trading system and to pre-empt pro-cyclical policies by crisis-stricken countries.*

Global economic decision-making

- **The crisis has made it all too clear that globalization of trade and finance calls for global cooperation and global regulation. But resolving this crisis and avoiding its recurrence has implications beyond the realm of banking and financial regulation, going to the heart of the question of how to revive and extend multilateralism in a globalizing world.**
- **The United Nations must play a central role in guiding this reform process. It is the only institution which has the universality of membership and credibility to ensure the legitimacy and viability of a reformed governance system. It has proven capacity to provide impartial analysis and pragmatic policy recommendations in this area.**

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Abbreviations

BIS	Bank for International Settlements
CBOT	Chicago Board of Trade
CDO	collateralized debt obligations
CDS	Credit Default Swaps
CEA	Commodity Exchange Act
CEBS	Committee of European Banking Supervisors
CESR	Committee of European Securities Regulators
CITs	commodity index traders
CFTC	Commodity Futures Trading Commission
COT	Commitments of Traders
DJ-AIGCI	Dow Jones-American International Group Commodity Index
ECB	European Central Bank
FED	Federal Reserve System
FSA	Financial Services Authority
GDP	gross domestic product
ICE	Intercontinental Exchange
IMF	International Monetary Fund
LTCM	Long-term Capital Management
OTC	over-the-counter
NEER	nominal effective exchange rate
PEER	price component of REER (PEER=NEER/REER)
PPP	purchasing power parity
REER	real effective exchange rate
RMBS	residential mortgage-backed securities
SIVs	Structured Investment Vehicles
S&P GSCI	Standard & Poor’s Goldman Sachs Commodity Index

Foreword by the Secretary-General of UNCTAD

The global deleveraging that first hit the world economy in mid-2007 and that accelerated in autumn 2008 could not have been possible without the rare coincidence of a number of market failures and triggers, some reflecting fundamental imbalances in the global economy and others specific to the functioning of sophisticated financial markets. Chief among these "systemic" factors were the full-fledged deregulation of financial markets and the increased sophistication of speculation techniques and financial engineering. Other determinants were also at play, particularly the systemic incoherence among the international trading, financial and monetary systems, not to mention the failure to reform the global financial architecture. Most recently, the emergence of new and powerful economic actors, especially from the developing countries, without the accompanying reform needed in the framework governing the world economy, accentuated that incoherence.

For many years, even when the global economic outlook was much more positive than today, UNCTAD stressed the need for systemic coherence. It has regularly highlighted the shortcomings of the international economic system and has defied mainstream economic theory in its justification of financial liberalization without a clear global regulatory framework. UNCTAD has drawn attention to the fact that the world economy was overshadowed by serious trade imbalances and has questioned how they could be corrected without disrupting development. We have warned that, in the absence of international macroeconomic policy coordination, the correction could take the form of a hard landing and sharp recession. In recent years, we noted the growing risk that the real economy could become hostage to the whims and volatility of financial markets. Against this background, UNCTAD has always argued in favour of stronger international monetary and financial governance.

A better understanding is required of how lack of proper financial regulation set the scene for increasingly risky speculative operations in commodities and currency markets and of how across-the-board financial deregulation and liberalization have contributed to global imbalances. In doing so, a clearer vision may emerge of how these and other systemic shortcomings can only be remedied by vigorous reform of the international monetary and financial systems through broad-based multilateral cooperative processes and mechanisms that strengthen the role of developing countries in global governance.

Against this backdrop, I established in October 2008 an UNCTAD interdivisional Task Force on Systemic Issues and Economic Cooperation, chaired by the Director of the Division on Globalization and Development Strategies. This group of UNCTAD economists was tasked with examining the systemic dimensions of the crisis and with formulating proposals for policy action nationally and multilaterally. Needless to say, the development dimension and the appropriate responses are at the forefront of UNCTAD's concerns and the issues addressed in this report were identified with that in mind.

There can be no doubt that, apart from the need to strengthen financial regulation at the national level, the current problems of the global economy require global solutions. The United Nations must play a central role in this reform process, not only because it is the only institution which has the universality of membership and credibility to ensure the legitimacy and viability of a reformed governance system, but also because it has proven capacity to provide impartial analysis and pragmatic policy recommendations in this area.

Supachai Panitchpakdi
Secretary-General of UNCTAD