

National Workshop on Reforms for Economic Development of Myanmar

Subject: IMF, U.S. Dollar, and
Global Financial Crisis

Presenter: U Myint

Venue: Myanmar International Convention
Centre (MICC)
Naypyitaw

Date: 19 August, 2011

Time: 14:20 – 14:40

Introduction

1. Many seminars and talks, by numerous speakers, with various backgrounds, have already been held in Yangon on the global financial crisis.
2. Since economic issues are too important to be left to economists, this is to be welcomed.
3. After so much has been talked about, written in newspapers and journals, why hold another seminar on global financial crisis?

Why another seminar on global financial crisis?

1. Global financial crisis raises complex issues, and many seminars, talks and lectures, from various points of view, are needed to help find out what it is all about.
2. The crisis continues to attract considerable interest, and final curtain on matter has not come down as yet.
3. In this seminar, we hope to look at issues not taken up before, and to try not to go over ground already covered by most speakers.

Aims of present workshop

1. To distinguish between a disease and its symptoms.
2. The idea that the global crisis represents a warning that something is very wrong with the present world financial system.
3. If so, what is basically wrong with the present system?
4. How can this wrong be corrected?
5. How does all this affect poor countries?

The IMF and the US dollar

1. Some important aspects of the global financial crisis, and issues discussed in this seminar, can be better understood by looking at two things.
2. The first, is to look at how the International Monetary Fund (IMF) is set up and how it works.
3. The second, is the role of the United States Dollar in world trade and finance.

The Bretton Woods Conference

1. The United Nations Monetary and Financial Conference was held at Bretton Woods, a town in New Hampshire State, USA.
2. The Conference was held in July 1944 – a time when World War II was still raging.
3. The Conference was attended by 44 countries and it adopted the Bretton Woods Agreements.

Bretton Woods Agreements

1. The Bretton Woods Agreements established the IMF and International Bank for Reconstruction and Development (IBRD) or World Bank.
2. IMF and World Bank are therefore often referred to as Bretton Woods institutions or Bretton Woods system.
3. IMF and World Bank started work in 1945 when a sufficient number of countries had rectified the Bretton Woods Agreements.

Functions of World Bank and IMF

1. Briefly put, the World Bank is to take care of postwar reconstruction, and following that -- to assist development of developing countries. The IMF, on the other hand, is to take care of international payments, monetary, fiscal and financial matters.
2. For example, if due to bad weather and poor harvest, exports fall, there is a trade deficit and a country needs help – go to IMF.
3. To build a road, dam, bridge, sea port, air port, power station – go to World Bank.

How IMF works (1)

IMF does many things. But to keep matters simple, and to serve our present purpose, we need to only mention the following:

1. IMF has 187 member countries.
2. A “quota” is set for each member.
3. Size of quota for a country depends on its economic situation such as per capita GDP, its importance in world trade, etc.
4. Myanmar's quota at present is SDR258.4 million.
5. On 14 March 2011: 1SDR = US\$ 1.5771
6. So Myanmar's quota = US\$402.4 million on that date.
7. Special Drawing Rights (SDR) will be explained in detail later.

How IMF works (2)

6. Examples of quotas of few other countries in million SDRs:

<u>Country</u>	<u>Quota in SDRs (mil.)</u>
Laos	52.9
Cambodia	87.5
Thailand	1,081.9
India	4,158.2
China	8,090.1
Japan	13,312.8
USA	37,149.3

7. Total quotas of all countries = SDR 219.1 billion.
8. A member country's subscription to IMF, voting power, and access to IMF assistance depend on its quota.

How IMF works (3)

9. Each member country deposits in IMF:
 - (a) 75% of its quota in its domestic currency;
 - (b) 25% of its quota in hard currency (such as US dollar, Euro, Japanese Yen, UK pound sterling, etc.).
10. When 187 member countries make such deposits, IMF will have a fund of domestic currencies of members and hard currencies.
11. Hence we have an international monetary fund.

Use of IMF funds (1)

1. Members get help from IMF by purchasing any foreign currency it wants from IMF with its domestic currency.
2. This will increase the amount of the country's currency held by IMF.
3. Suppose Myanmar purchases US dollars amounting to 25% of its quota with kyats.
4. Since IMF already holds 75% of Myanmar's quota in kyats, this will mean IMF holding of kyats will rise to 100% of quota.

Use of IMF funds (2)

3. Purchase of foreign exchange for first 25% of quota is called purchase in “first tranche” and can be done without much fuss.
4. Purchases of second 25% of quota – “second tranche”, followed by third and fourth tranches, become increasingly more difficult, and the country must meet IMF conditions, such as requirement to make economic reforms and economic policy changes before the funds are released.

Repurchase provision

1. After purchase of foreign exchange from IMF with local currency, the country is required to buy back, or repurchase, its local currency from IMF with foreign exchange, within 3 years to 5 years.
2. Hence IMF help is only short-term.
3. IMF acts somewhat like a pawn shop. If you are desperately in need of cash, you pawn your wife's jewels at pawn shop. After crisis is over, you repurchase (buy back) jewels, or your wife will not love you any more.

Voting Power in IMF

1. Each member country has 250 basic votes plus one vote for SDR100,000 of its quota.
2. Myanmar has 3,266 votes which account for 0.14% of total votes in IMF.
3. Due to its very small percentage of total votes Myanmar has joined the South East Asia Voting Group.
4. South East Asia voting group has 13 members -- 10 ASEAN countries + Fiji, Nepal and Tonga. The Group has 89,139 votes which account for 3.85% of total votes.
5. Other countries with small voting rights also form voting groups. There are over a dozen such voting groups in IMF.

Voting Power in IMF: Major Players

	<u>Number of votes</u>	<u>Share in total</u>
1. USA	372,175	16.05%
2. Japan	133,810	5.77%
3. Germany	130,764	5.64%
4. France	108,067	4.66%
5. UK	108,067	4.66%
6. China	81,583	3.52%
7. Saudi Arabia	70,537	3.04%
8. Russia	60,136	2.59%
9. India	42,264	1.82%
10. Brazil	31,043	1.34%

World Bank President is appointed by USA.

IMF Managing Director is appointed by EU.

International money

1. When citizens of different countries engage in trade, and buy and sell from each other, they need “international money” to engage in business.
2. International money is money that will be accepted by all countries to make payments, and to settle debts and accounts. International money is also called “international means of settlement” or “international liquidity”.

The gold standard (1)

1. Under the gold standard that existed until the 1920s, gold served as international money.
2. Under this system, each country fixes value of its domestic currency in terms of a weight in gold.
3. For example, Myanmar fixed the value of kyat, at a rate where:
one ounce of gold = kyats 166.667
4. USA fixed:
one ounce of gold = 35 dollars

The gold standard (2)

5. If ounce of gold = US\$35 = K166.667
6. Then $\$1 = 166.667/35 = \text{K}4.7619$
7. That is the official K/\$ exchange rate when Myanmar got independence in 1948.
8. Under the gold standard, suppose Myanmar exports \$20 mil. to and imports \$15 mil. from India over a certain period.
9. Then India central bank has to pay difference of \$5 mil. in gold to Myanmar central bank.

Gold standard and supply of international money

1. The main source of supply of gold for the gold standard comes from gold mining.
2. Gold mining, like any other mining activity, does not ensure a steady and sure increase of gold supply – it is nature of mining that you may find gold or may not find gold.
3. Whereas, a steady and assured increase supply of gold to serve as international money is needed to finance a steadily growing world trade.

Gold standard and liquidity problem

1. Experience shows world gold supply only increase about 1.3% per year.
2. World trade expands many times that rate.
3. If world money supply increases at a much slower rate than the growth in world trade, we have a “liquidity” problem.
4. Liquidity problem arises when there is shortage of money. For example, nuisance caused by shortage of K10, K20, K50, K100 and K500 notes.

Gold exchange standard

1. The solution to the gold standard liquidity problem, is to set up a new system called the “gold exchange standard”, beginning in the late 1920s.
2. Under the gold exchange standard, gold together with foreign exchange (mostly US dollar and UK pound sterling) are used as international money. That is, under the new system, gold, US dollar and pound sterling serve as international or world money.

Reserve currencies

1. US dollar and pound sterling that serve as international money are also called “reserve currencies”.
2. This is because these currencies held by central banks are called official “foreign exchange reserves”.
3. The amount of foreign exchange reserves held by the central bank compared to the value of imports is an important measure of a country’s economic situation. For example, we can talk about foreign exchange reserves amounting to 3 months of imports, 6 months of imports, etc.

Monetary and non-monetary gold

1. Gold that serves as international money consists of gold in the vaults of central banks of countries in the world.
2. That price of gold is used to be fixed officially at one ounce = 35 US dollars.
3. But gold is a useful commodity in its own right and serves many desirable non-monetary purposes.

Demand for non-monetary gold

1. Jewellery industry demands gold.
2. Gold is a good electric conductor, and is very useful in electroplating and electronic industries. It is used in components in satellites that go to outer space.
3. Gold hoarders (especially people in Latin America, Middle East and India) keep gold as form of wealth and for security.
4. Gold speculators, hold gold to make profits through speculation.

Types of world gold holdings: 2008

<u>Gold Holding type</u>	<u>Share (%)</u>
Jewellery	52%
Central Banks	18%
Investments (bars & coins)	16%
Industrial	12%
Unaccounted	<u>2%</u>
World total	100%

Market for gold

1. If gold is a useful commodity, those who want it will pay a price for it, those who have it will be willing to sell it at a price – that is, there will be a market for gold.
2. Markets for gold exist in London, Paris and Zurich. By far the biggest is London.
3. When there is a market for gold, market and official prices should not be too different. If market price is much higher, there will be loss of trust and credibility in the official price.

Increasing monetary gold price

1. Suppose monetary gold price is one ounce = 35 dollars and price on gold market is one ounce = 40 dollars.
2. One way to make official price close to market price is to increase official price of gold to 40 dollars per ounce.
3. This will not only increase value of existing monetary gold stock but higher prices will encourage gold production, increase gold supply and will further help ease liquidity problem.

Difficulty in raising monetary gold price (1)

1. Equity problem: Central banks of rich countries hold largest share of world's monetary gold stock. In 1970, of \$ 41 billion monetary gold stock, developed countries held \$ 35.7 billion, which is 87% – so raising gold price makes rich, richer.
2. Political problem: largest gold producers in world are South Africa and Soviet Union. Increase gold price will benefit them. This is not desired for political reasons -- South Africa because of its racial policies, and Soviet Union because it was competing with Western powers for influence in the world arena.

Difficulty in raising monetary gold price (2)

3. Prestige problem: Raising dollar price of gold means devaluation of dollar – and loss of prestige for USA. This is especially so, as US made several countries in South America hold dollars as official reserves.
4. Confidence problem: If official price of gold is raised when market price is higher, then people will worry if this will be done again – leading to loss of confidence in paper currency.

Monetary gold production is a useless economic activity (1)

1. Monetary gold, like any other gold, must be dug out of the ground, by digging big holes.
2. The gold ore thus obtained is processed, refined, melted and made into bricks.
3. Gold bricks are then transported thousands of miles and deposited in the vaults of central banks all over the world.
4. Vaults of central banks are nothing but big holes in the ground, fortified and well guarded.

Monetary gold production is a useless economic activity (2)

5. Monetary gold production therefore means digging gold out of one big hole and burying it again in another big hole.
6. This is not a useful economic activity.
7. Whereas, non-monetary gold production, satisfies human wants, and is a useful economic activity.
8. Hence, most economists want to stop using gold as money, and to cut link of gold to money.

Need to keep official and market gold price in line

1. If market price of gold is out of line and consistently much higher than the official price of gold at \$35 per ounce, then official price will appear weak and unreliable.
2. To strengthen confidence in the official price, it is necessary to keep market price close to official price.
3. This can be done by “market intervention” in the gold market by setting up a “gold pool” by a group of rich countries.

Gold pool to control market price of gold

1. Central banks of USA, and 7 other Western nations set up the gold pool in early 1960s.
2. Aim of gold pool is to keep the market price of gold in the London market between \$35.08 and \$35.20 per ounce.
3. If price of gold falls to \$35.08, gold pool agent will buy gold, so price does not fall further. This will increase gold in pool.
4. If price of gold rises to \$35.20, gold pool will sell gold, so price don't rise further. This will reduce supply of gold in pool.

Gold pool and Pound Sterling devaluation of 1967

1. Arrangements under gold pool seem to work well for several years.
2. But when the British pound was devalued on 18 November 1967, there was loss of faith in paper currency. There was fear, the dollar will be devalued as well.
3. When there is loss of faith in paper currency, what you do is go to London and other gold markets and buy gold with all the dollars and pounds that you own.

End of gold pool

1. Within one week after pound devaluation gold hoarders and speculators bought 250 tons of gold (valued at \$280 mil.) on London market.
2. This mad gold buying continued with increased frenzy into March 1968.
3. On 14 March 1968, \$200 mil. worth of gold was bought in one day alone. By this date the gold pool had lost \$3 bil. worth of gold.
4. This was too much, and the pool was disbanded on 17 March 1968.

Gold price rise in London market

With disbanding of gold pool, London market gold price was set free. The price rose as follows:

<u>Year/date</u>	<u>Price per ounce</u>
1970	\$37.4
1975	\$140.3
1985	\$327.0
1995	\$369.6
2005	\$513.1
2011 (14 March)	\$1,428.1

World official gold holdings in Dec 2010

■	<u>Country</u>	<u>Gold holding</u> (tons)	<u>Share of total</u> (%)
1.	USA	8,134	26.6%
2.	Germany	3,402	11.1%
3.	Italy	2,452	8.1%
4.	France	2,435	8.0%
5.	China	1,054	3.4%
6.	Switzerland	1,040	3.4%
7.	Russia	775	2.6%
8.	Japan	765	2.5%
9.	India	558	1.8%
10.	Other countries	<u>9,948</u>	<u>32.5%</u>
11.	World total	30,563	100.0%

Need for new kind of world money

1. With all sorts of problems associated with gold and paper money – why not come up with another type of world money, that is not gold and not paper.
2. This new type of world money is the “Special Drawing Rights” (SDRs) of IMF.
3. The decision to create SDRs was taken at the annual meeting of IMF Board of Governors, held at Rio de Janeiro, Brazil, in September 1967.

Special Drawing Rights (1)

1. SDR is called an “international reserve asset” and together with gold, and reserve currencies (dollar, Euro, pound, yen, etc.) are to be used as international money.
2. SDR is not gold and not paper money. It only exists in the books of the IMF.
3. This is nothing new. In developed countries, currency notes and coins are no longer used much for market transactions. Instead, credit cards and bank accounts are used.

Special Drawing Rights (2)

4. SDRs amounting to \$3.5 billion were created for first time in 1 January 1970.
5. At that time 1SDR = 1US\$.
6. SDRs are allocated to each IMF member country according to its quota.
7. For example, in 1970 Myanmar's quota was \$48 million; total quotas was \$21 billion.
8. So Myanmar's share = $\$3.5 \text{ bil} \times 48/21,000$
= SDR 8 million.

Special Drawing Rights (3)

9. An IMF member can use SDRs to settle payments with any other IMF member. Such settlements are done by transferring SDRs from one member's account to another's account in IMF's books.
10. Additional SDRs are created from time to time, as felt required by IMF authorities.
11. Quota can also be increased over time, depending on a country's economic performance compared to others.

SDR valuation

1. At present one SDR is composed of a basket of four currencies in following proportions:

US\$ =	41.9%
Euro =	37.4%
Pound sterling =	11.3%
Japanese Yen =	<u>9.4%</u>
Total =	100.0%

2. Value of SDR, and percentages of currencies in the basket are changed by IMF Executive Board every 5 years.

Valuing SDR in US dollar (1)

In addition to the percentages of 4 major world currencies that form SDR, the amounts of each currency in the SDR is also fixed and specified by the IMF Executive Board for every 5 years. For the present 5 year period, these are as follows:

<u>Currency</u>	<u>Amount</u>
US dollar	0.6600
Euro	0.4230
Pound sterling	0.1110
Japanese yen	12.1000

Valuing SDR in US dollars (2)

1. Value of SDR in US dollars changes every day and is available from IMF web-site. For example, for 14 March 2011, the dollar exchange rate for each of 4 currencies in SDR prevailing on that date is used and the following calculation is made:

<u>Currency</u>	<u>Amount</u>	<u>Exchange Rate</u>	<u>Value in US\$</u>
US dollar	0.6600	1.0000	\$0.6600
Euro	0.4230	1.3960	\$0.5905
Pound	0.1110	1.6105	\$0.1788
Yen	12.1000	81.8700	<u>\$0.1478</u>
		1 SDR =	\$1.5771

Myanmar's official exchange rate

1. On 2 May 1977, Myanmar's official exchange rate was fixed at:

$$1\text{SDR} = \text{K}8.5085$$

2. This rate has not been changed up to now.
3. As noted above, on 14 March 2011:

$$1\text{SDR} = \text{US\$ } 1.5771$$

4. So on 14 March 2011:

$$\text{US\$}1 = 8.5085/1.5771 = \text{K}5.3950$$

5. That is official K/\$ exchange rate on 14 March 2011.

End of gold exchange standard

1. After collapse of gold pool in March 1968, and SDR creation beginning in January 1970, knock-out punch to gold exchange standard came in 1971 when US President Nixon cut link of dollar to gold by abolishing the fixing of official price of \$35 for one ounce of gold.
2. This was called “Nixon shock” and it ended the gold exchange standard.

SDRs and reserve currencies (1)

1. With ending of gold's role as international money, we are left with SDRs and reserve currencies (now US dollar, Euro, pound sterling, yen) that all, or most countries will accept to make payments in international economic and business transactions.
2. How good are SDRs and reserve currencies in doing their job? How well have they served the world community, both rich and poor?

SDRs and reserve currencies (2)

1. Upto September 2009, a total of SDR 204 billion has been issued and allocated to IMF members -- not a large amount compared to financial flows in world economy that are taking place in trillions of dollars.
2. In March 2009, the Governor of China's Central Bank, proposed that SDR should replace the US dollar as reserve asset (that is, international money).
3. Why?
4. To find out, we have to consider economic, social and political consequences of using a domestic currency of one country (USA) as international money by rest of world. This is taken up below.

Use of reserve currencies and especially US dollar (1)

4. At present, US dollar, together with a few other hard currencies (euro, pound sterling, yen, etc.) are used as reserve currencies or world money.
5. As stated earlier, these currencies will be accepted by all or most countries in buying and selling and in carrying out trade and other economic and business transactions among themselves and with USA.

Use of reserve currencies and especially US dollar (2)

6. Among reserve currencies, by far the widest and largest amount used in international transactions is the US dollar.
7. US dollar has long history as reserve currency. It is well-known, familiar and trusted by most people in world.
8. US is biggest economy, biggest market, its banks, companies and businesses are spread all over the world.
9. We will therefore concentrate on US dollar.

Demand for US dollars for world economic and trade dealings

There are three types of demand, namely:

1. Transaction demand: to meet demand for money in transactions – to buy and sell in market.
2. Precautionary demand: to have money in store for security and to meet unexpected events and emergencies.
3. Speculative demand: to have money for use to speculate in foreign exchange, commodity, stock and financial markets.

Supply of US dollars for world economy (1)

1. How does the world gets dollars to use as international money? How can the world increase its supply of dollars to use as international money?
2. To answer, look at trade relations between US and rest of world (R/W).
3. When R/W sells goods and services to US, it gets dollars from US. When R/W buys goods and services from US, it gives up dollars to US.

Supply of US dollars for world economy (2)

4. For R/W to increase its dollar supply, the value of goods and services it sells to US must be larger than the value of goods and services it buys from US, that is, it must have a trade surplus with US.
5. From US point of view, US must buy more than it sells to R/W, that is, must have a trade deficit with R/W, for R/W to increase its supply of dollars.

Adjustment issue

1. When most countries have trade deficit, they cover deficit by drawing down foreign exchange reserves, by borrowing, or asking IMF for help. But these measures are only good for short term, or a few years.
2. If trade deficit is due to a serious “structural” problem and deficit continues, year after year for many years, the country must take “adjustment” measures, to increase exports, reduce imports, or both.

Adjustment and reserve currency country

1. A country like US, whose domestic money is used as reserve currency, does not have to take adjustment measures to correct its trade deficit with rest of world.
2. In fact, US had trade deficits with R/W for the most part of the past 60 years.
3. Reason is dollars that flowed to R/W are used for transaction, precautionary and speculative purposes and not only to buy goods and services from US.

US trade deficit and financial flows to world economy

1. Trade deficit of US for many years has flooded world with dollars which are used to meet world demand for world money.
2. The large amounts of dollars in R/W are held by central banks as exchange reserves. At present, these amounted to \$7.4 trillion. Of this, China held \$2.62 trillion and Japan \$996 billion.
3. Large amounts of dollars are also held by the private sector in R/W.

Benefits of US trade deficit and US\$ as reserve currency (1)

1. US trade deficit has helped ease shortage of world money or world liquidity.
2. The cause of deficit is American consumers huge appetite for imports which amounted to \$2.3 trillion in 2007.
3. Selling goods in the huge US market bought rapid income growth and prosperity to India, China and many other countries in R/W.

Benefits of US trade deficit and US\$ as reserve currency (2)

4. Goods sold in the US market are produced in China, India & R/W by US multinationals.
5. Multinationals gave technology, know-how, enterprise, capital, management and marketing skills to Indians, Chinese & others in R/W to make lap-top computers, digital cameras, washing machines, out-sourcing services, etc., using cheap labour.
6. Large amounts of these goods and services went to US and other Western countries.

Three big flows in world economy

There are said to be three big flows in the world economy. They are:

1. First, flow of technology, know-how, capital, enterprise from US to China, India & R/W.
2. Second, flow of goods and services from China, India & R/W to US.
3. Third, financial flows between US and R/W.
4. These 3 flows improved productivity, incomes and living standards in US and its trade partners in developing world over the past decade.

Disadvantages of US trade deficit and US\$ as reserve currency (1)

1. Use of domestic currency of a country (like US), as reserve currency, brings some very useful benefits to that country.
2. For example, consider \$7.4 trillion held by central banks of R/W as foreign exchange reserves.
3. Every US dollar that is held by a person, a business, an organization or central bank in R/W, represents a claim on the USA.

Disadvantages of US trade deficit and US\$ as reserve currency (2)

4. That is, a non-US person, that has dollars, can use those dollars to buy anything he wants from USA. USA must sell what he wants, provided the item is not a nuclear bomb, or a banned substance.
5. But if the non-US person, does not buy anything from US, but just holds on to the dollars because he needs dollars for trade, security and speculative purposes, the person is not using his claim on US.

Disadvantages of US trade deficit and US\$ as reserve currency (3)

6. When person A has claim on person B, but if A holds on to claim, and does not make use of this claim, it means A is giving a loan to B.
7. Trillions of dollars held by R/W central banks, and more trillions held by R/W private sectors, represent loans to US. These loans are for periods over which US has trade deficits with R/W, that is for 50 to 60 years.

Disadvantages of US trade deficit and US\$ as reserve currency (4)

8. Question is why should USA, largest and one of richest countries be given loans of trillions of dollars for 50 to 60 years.
9. Poor countries deserve to get loans more than USA.
10. This is important defect of the present world financial system.

Holding excessive exchange reserves is not good

1. At present China has nearly \$2.62 trillion worth of foreign exchange reserves.
2. Most of these are used to buy US treasury bonds, and kept at US banks and other financial institutions, to earn interest and income.
3. Keeping excessive reserves is wasteful and not good.
4. Because the funds could be used for more useful purposes within China.

Fantasy of Myanmar as reserve currency country

1. Digression: Suppose, Myanmar's local currency kyat is used as reserve currency and world money, what will happen?
2. Suppose, Myanmar has loan of half trillion dollars (\$500 bil.) for 20 years. Then what?

Consequences of huge “loan” from R/W to US

1. High consumption with US saving rate falling to zero over the past years.
2. Engaging in military adventures abroad and buying up companies of other countries.
3. Providing easy credit at high risks to buy houses as well as giving easy credit to banks and other financial institutions.
4. Not providing them with proper supervision.
5. Over recent years, income distribution in US was getting worse -- particularly for those at the bottom. There was political pressure to do something about this and measure adopted was to give very easy credit to low income people to buy houses, houses in turn provided collateral to buy many other things. When the housing "bubble" bursts, house prices fell, loans cannot be paid back, many lost their properties, and that triggered the financial crisis.

Leading role of US in IMF and World Bank

1. IMF and World Bank have not been able to properly play role for which they were established.
2. Due to US dominance, these institutions often act to achieve political and foreign policy objectives of USA.
3. Established over 60 years ago, IMF and World Bank, their policies and way they work, often do not reflect present realities.

Washington consensus (1)

1. Fall of Berlin wall, end of Soviet Union, changes in Eastern Europe, led to loss of faith in socialism, communism and central planning to promote economic growth.
2. This was greeted with much happiness in West, and especially in Washington.
3. It resulted in what is called “Washington Consensus”.

Washington consensus (2)

4. “Washington” means US Treasury Department (finance ministry), IMF and World Bank. They are all in Washington.
5. “Consensus” means agreement or understanding.
6. What measures are recommended under Washington consensus? These include:
7. Liberalize, privatize, allow freer play of market forces.

Washington consensus (3)

8. Liberalize banking and insurance business, open up markets for trade and investment.
9. Encourage greater flow of international finance and capital.
10. Outward-orientation, and to participate in and take advantage of the information revolution and the globalization process.
11. Government should get out of direct production.

Washington consensus (4)

12. Instead, government should concentrate on governing country, promoting law & order.
13. Providing essential public services (such as health, education, social welfare, protecting environment).
14. And doing things that are market-friendly and that support private initiative.

Washington consensus (5)

15. To sum up, Washington people are saying: “if you want to become a modern developed country like us, there is now only one way left for you to go, and that is to go our way, and way we have been telling you to go for the past several decades.”
16. This advice was well received. Even Myanmar, the last country to take advice from Washington, wants to establish “a market-oriented economic system”.

Washington Consensus: Serious flaws (1)

1. It took over 100 years to set up free enterprise market system as it exists now in US.
2. In its early history, US faced same problems as in developing countries today.
3. But after many years, US set up mechanisms – checks and balances – to make its free market system work in a more effective and socially responsible way.

Washington Consensus: Serious flaws (2)

1. Americans would readily agree their checks and balances and control mechanisms are not perfect.
2. For example, Enron and several other large US corporations provided misleading information about their performance and falsified accounts.
3. Revelations of misconduct by some prominent US Chief Executive Officers (CEOs) have been devastating.
4. These CEOs have given to themselves luxury yachts, mansions, large chunks of shares in their companies and millions of dollars to take home as their salaries.

Washington Consensus: Serious flaws (3)

5. However, despite these shortcomings, control mechanisms in the US have wide powers to limit such excesses and prevent them from getting out of hand.
6. The present global crisis itself is due to the process of deregulation and downplaying and not making effective use of control mechanisms the US has -- to see that its banking, finance and business corporations do not misbehave and act in unethical and anti-social ways. That is now going to change, and required regulations are going to be reintroduced and enforced.

Washington Consensus: Serious flaws (4)

7. Control mechanisms, that US has developed over many years, just do not exist in developing countries of today.
8. Liberalization, especially of financial and capital markets, hold special dangers.
9. Free flow of short-term capital – is like driving Shan Star car, with Mercedes Benz engine, no brakes, at high speed, on busy highway, where there are no traffic rules, not even to drive on road's right or left side.

Short term capital flows and the Asian financial crisis (1)

1. Main thing that caused Asian financial crisis of 1997/98 was huge flow of private capital into and out of these countries within a very short time.
2. In 1996, there was a net private capital inflow of \$97 billion into these countries. Then in the latter half of 1997, the flow reversed itself and there was a net outflow of \$12 billion.

Short term capital flows and the Asian financial crisis (2)

3. This means there was a turnaround of \$109 billion within a period of about 6 months, a very large sum of money for these countries. It amounted to 10% of their combined GDP.
4. There is general agreement that the Asian financial crisis is mainly due to this big and devastating turnaround in short-term capital flow that occurred in these countries.

Reforming international financial system

1. In October 2008, UN Secretary General appointed a High-Level Experts Task Force.
2. Task Force is to “undertake a comprehensive review of the international financial system, including the major international economic institutions”.
3. Task force is led by Joseph Stiglitz.

April 2007, Washington, D.C., USA; Woodrow Wilson International Center. From left to right: U Thet Tun, U Myint, Joseph Stiglitz, Ronald Findlay, U Myat Thein.



Views of some key developing countries (1)

1. Brazil, Russia, India and China (BRIC) held first annual summit in Russia on June 16 2009.
2. Aim is to develop common position on international financial reform and climate change.
3. BRIC now account for 22% of world economy and the four countries together have 9.27% of total votes in the IMF.

Views of some key developing countries (2)

4. In recent months, Russian, Chinese and Brazilian officials said they want to move away from U.S. dollar and to use more domestic currency in bilateral trade.
5. They have also talked about alternate reserve currencies and reserve diversification.
6. BRICs are thinking of buying each other's bonds to lessen dependence on U.S. dollar.

Views of some key developing countries (3)

7. BRICs want stable, predictable and more diversified international monetary system.
8. BRICs have agreed to buy forthcoming IMF bonds to help raise needed funds. China has agreed to buy up to \$50 billion, and Russia, India and Brazil have pledged to buy \$10 billion each.
9. For these contributions, they all seek greater voting power in IMF.

Reforming institutions – IMF and World Bank (1)

1. IMF and World Bank should be more democratic and not run by a few.
2. They should reflect present realities in world economy.
3. They should not be used to serve political and foreign policy objectives of major powers.
4. Developing countries should have more say and should receive more equitable benefits.

Reforming institutions – IMF and World Bank (2)

5. Resources and technical expertise in IMF and World Bank should be more effectively used to help address financial and economic problems causing deep concern to international community.
6. Action should be guided by better policies – Washington consensus must go.

Question of poor countries: the bottom billion (BB) [1]

1. Not long ago, developed countries had one billion people, while developing countries had 5 billion people.
2. Now many developing countries are making good economic progress – India, China, Korea, Brazil, Singapore, Thailand, Malaysia, etc. They are on move, and gaining momentum. So at present, no need to worry too much about them. Four billion in developing countries are therefore OK.

Question of poor countries: the bottom billion (BB) [2]

3. What is worrisome are countries that have not moved, but are said to be “falling behind and falling apart.”
4. There are 58 such countries – mostly in Africa but a few also in other parts of world.
5. A billion people live in these countries – they are the bottom billion (BB).
6. Why worry about them – look at Somalia, a failed state, it's people with no way out, became sea pirates – causing major menace to world.

Bottom billion (BB) and global financial crisis (1)

BB countries think they are immune to global financial disease, because:

1. They are in isolation ward – not much dealing with US and outside world.
2. Economy is underdeveloped – no stock market, banking sector is in kindergarten stage, no multinationals, no need to worry about reserve currencies, as not much reserve currencies are in country.

Bottom billion (BB) and global financial crisis (2)

3. There is also a belief that as underdeveloped countries, financial disease cannot do much harm to BB. For example, such low level economy is like staying on ground floor of building, so will not get hurt when falling out of window.
4. But if living in high flying economy and on 10th floor, falling out of window can be very painful.
5. Better still, if you stay in basement, there is no window to fall out of.

Bottom billion (BB) and global financial crisis (3)

6. Financial disease can be kept out by taking “administrative measures” – close border trade, cancel import and export licenses, arrest foreign exchange dealers.
7. Immunity of BB countries can also be seen from official statistics. When many neighbours are showing minus GDP growth rates, a BB country continues to grow at high rates.
8. So indicating no problem from financial and other exotic diseases.

Problems with thinking BB countries are immune to global financial disease (1)

1. Isolation ward and underdeveloped economy: BB countries cannot set up isolation ward in globalizing world; through underground, informal or non-official economy, BB economies are very much linked with outside world.
2. Living in basement: when world is in crisis, and sky falling all around you, you don't have to be a civil engineer to know that the last place you should be is the basement.

Problems with thinking BB countries are immune to global financial disease (2)

3. Closing border trade: Land border – mountains, forests, malaria, rough terrain – will require thousands of special forces, hundreds of guard outposts – manned with officials who must be honest, and must be provided with sufficient funds and equipment to close border.
4. Sea border – will require whole navy to patrol coast.
5. Costs of these will be many times more than value of goods kept out or kept in.

Problems with thinking BB countries are immune to global financial disease (3)

6. Official statistics: Official statistics deal with the formal or official economy. It is possible to have high growth in this economy, while at same time global financial disease brings disaster to the county's population.
7. This is because majority of people in BB countries live in non-official or informal economy.
8. Since informal economy is linked with outside world, it is economy that gets devastated by global financial crisis.

Problems with thinking BB countries are immune to global financial disease (4)

5. Moreover, large human costs that young people and poor families from BB countries have to bear in neighbouring countries and in border areas, due to global financial crisis, can never be quantified, no monetary value can be placed on them, and can never be reflected in official statistics.

Problems with thinking BB countries are immune to global financial disease (5)

6. So the idea that BB countries need not worry about external economic shocks, is very wrong.
7. This is because a poor country, with undiversified economic structure, poor infrastructure, insufficient foreign reserves, and limited administrative capability does not have effective shock-absorbers, or resilience and the capacity to cope with any type of economic disturbance -- man-made or natural.

Problems with thinking BB countries are immune to global financial disease (6)

8. And when crunch comes, burden falls heaviest on the poor, and masses at lowest rung of society in such a country.
9. In fact, easiness of BB countries to get devastated by economic disturbances, especially those originating outside their borders, is main reason why the international community has recommended that they be given special treatment in aid, trade, debt relief, and technology flows.

Financial crisis: concluding remarks (1)

1. Financial crises have been occurring, with increased frequency, at different times and different places all over the world.
2. The present one is global.
3. Failed banks and financial institutions have to be closed down or bailed out. Likewise, bankrupt firms have to be shut or helped. Assistance has to be given and jobs provided to those unemployed.

Financial crisis: concluding remarks (2)

4. The fact that financial crises keep coming again and again, is giving warning that something basic is wrong. It is a sign, a symptom, of a serious disease.
5. To prevent further financial crisis, not only symptoms must be treated, but proper medication and treatment must be applied to cure the disease.

Financial crisis: concluding remarks (3)

6. The disease consists of defects and shortcomings in the present international financial system and its major institutions.
7. The hope is, with so much suffering and loss caused by the present global financial crisis, the warning will be heeded, and serious effort will be made to reform the world financial system and its institutions.

Concluding remarks for BB countries (1)

1. It is not true BB countries are not affected by global financial crisis.
2. On contrary, because they are usually helpless, and do not have capacity and means to protect themselves, the crisis will be more devastating for them.
3. If more devastating, BB countries should take keen interest in the global financial crisis – its causes, consequences, and remedies.

Concluding remarks for BB countries (2)

4. Having in-depth knowledge of the global financial crisis, will enable a BB country to join its neighbours and world community to set up a better international financial system and its institutions.
5. If BB countries suffer more from crisis, the best thing a BB country can do, is to leave this disgraceful group by undertaking economic reforms and to become a modern, developed nation.