

**NEW IDEAS IN DEVELOPMENT AFTER THE FINANCIAL CRISIS**

**PANEL IV:  
NEW APPROACHES TO INTERNATIONAL COOPERATION AND  
INSTITUTIONS AFTER THE CRISIS**

**MODERATOR:**  
LILIANA ROJAS-SUAREZ,  
SENIOR FELLOW,  
CENTER FOR GLOBAL DEVELOPMENT

**SPEAKERS:**  
KEMAL DERVIS,  
VICE PRESIDENT, DIRECTOR OF GLOBAL ECONOMY AND  
DEVELOPMENT, BROOKINGS INSTITUTION,

JUSTIN LIN,  
CHIEF ECONOMIST, SENIOR VICE PRESIDENT,  
WORLD BANK

SEBASTIAN MALLABY,  
DIRECTOR  
MAURICE GREENBERG CENTER FOR GEOECONOMIC STUDIES

MINXIN PEI,  
SENIOR ASSOCIATE,  
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

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LILIANA ROJAS-SUAREZ: Can the panelists please come to the podium and sit? Okay. We are now starting our very interesting discussion about the role of the multilateral organizations and cooperation among countries.

I'm very grateful for the invitation of participating in this very exciting conference and to have such a distinguished panelist in the table.

This week, as you'll know, is a very busy week. With both the multilateral organizations and countries dialing about what's going to happen over the weekend in terms of discussions and deliberations during these three meetings of the IMF. Everything that I hear points to a longer and deeper than previously expected crisis. And it's not because governments are in trouble, but because more and more we hear figures about problems in the private sector of developing countries. Just to give you an example, over the last three months, up to now, until the beginning of – or mid April, corporate in Latin America and international capital markets, there were \$4 billion of defaults, mostly from Brazil and Argentina, but signs are there that more problems in the private sector are emerging. In that context two facts stand out. Well, with respect to the multilateral organizations. We'll know that the role of the IMF has been expanded, but this weekend, the discussion is going to be not only in terms of more resources, but in terms of more activities and responsibilities.

The IMF has been traditionally in the role of supporting balance of payments. Although money's fungible, it has never been said that the IMF could actually use its resources for fiscal support. That begs the question, and I hope that some people in the panel will answer, what is now the role of the multilateral organizations? Is the IMF taking the leading role for just the crisis or is expanded balance sheet of all the multilateral organizations, which is actually coming, going to imply that after the crisis some consolidation is also going to be needed among the institutions?

On the country side, moving towards a G-20 decision making process rather than a G-7 is here to stay. But the question is whether we can truly achieve coordination between the largest players on a sustainable basis or we are just observing a crisis driven coordination. It seems to me that regionalism is what is going to be strengthened during and after the crisis. With some positive developments in some regions of the world like Asia, and some worrisome developments in some other regions of the world like Latin American with the countries in ALBA, I would also like to hear some views about that among the panelists.

So let me introduce our very distinguished panelists. The first one is Kemal Dervis, who of course we all know, who is now at Brookings and serves for the Commission on Growth and Development, the Center for Economic and Foreign Policy Studies Advisory Committee, the Turkish Economic and Social Studies Foundation advisory committee, as an advisor to the Institut de Prospective Economique du Monde Méditerranéen.

Now, I would be very long talking about Kemal. You all know that he's been in the Turkish parliament, that he was in the United Nations, but what I want to underline and to stress is his, by now, very famous book produced at CGD, at the Center for Global Development, "A Better Globalization," which is of course very, very to the point that we're discussing today.

Then we'll have Justin Lin, the very distinguished chief economist and senior vice president of the World Bank who has joined the World Bank after serving for 15 years as professor and founding director of the China Center for Economic Research at Peking University. He has served on several national and international committees, leading groups and councils on development policy, technology, and environment, including China's People Congress, the old China Federation of Industry and Commerce, the United Nations Millennium Task Force on Hunger, the eminent persons group of the Asian Development Bank, the National Committee of United States-China Relationship, the Hong Kong U.S. Business Council – okay I cannot continue, right, with my – it will be a speech.

Then, we'll hear from Sebastian Mallaby, currently the director of Maurice Greenberg Center for Geoeconomic Studies for the Council on Foreign Relations. Sebastian – well, he was very well-known as a – he's still a columnist and former editorial board member of the Washington Post. He has previously been a Washington bureau chief to The Economist I believe in the late '90s, the Tokyo bureau chief for The Economist also in the '90s, the international finance correspondent for The Economist, and the Africa correspondent also for The Economist. He is the author of two fascinating books. My favorite, I have to confess, is "The World's Banker," which I guess everybody knows, but also his book about the future of South Africa called "After Apartheid."

Finally, we'll here from Minxin Pei, a senior associate from Carnegie Institute for International Peace (sic), who is the author of a number of books and his researched has been published in Foreign Policy, Foreign Affairs, The National Interest, Modern China, China Quarterly, Journal of Democracy, et cetera, et cetera. He's a very well-known speaker and commentator on BBC World News, Voice of America, and National Public Radio, with a number of op-eds in the Financial Times, New York Times and all the major newspapers around the world.

With that prestige panel, I only remain to ask them to please remain within your 10 minutes allocation of time.

If I can please invite Kemal.

**KEMAL DERVIS:** Thank you very much, Liliana, and thank you to all of those who organized this event, to Nancy and to Frank. Justin just gave me his little book and there was the famous quote by Keynes that, "Sooner or later it is ideas that are important for good or evil." And I think that's what this is all about.

Now, let me just take a few minutes at the beginning before I go to the actual topic of the institutional setup of governance to give you my thoughts on where we're at in terms of this crisis, and of course the institutional reforms and the governance debate takes place within the framework of this evolving crisis. And I think some of us have said it before, but I want to, again, remind everybody, the real crisis only started really in September of last year. So this is six months. This is a very, very short period and we don't really know how things are going to evolve, and it's very, very early to say anything at all definite about that. But let me share with

you kind of three possible scenarios and a lot will depend on which scenario is going to be the one we're going to live through.

And the first scenario would be the scenario where policies work out, that the fiscal stimulus, which is quite massive now around the world, combined with the actions in the financial sector, actually reinforce one another that the banks indeed start lending again, that equity values start rising, asset values start rising slowly towards the end of the year. The fiscal stimulus works on the effect of demand side. Protectionism is stemmed and there's no major protectionist cycle. And we get to a recovery some time next year. And this is more or less what the consensus forecasts still are predicting.

Now, of course on the consensus forecasts, one thing one has to say is that they've been consistently wrong and changed. Every month, every month they've been changed. And so looking at these forecasts, obviously, one has a lot of doubts. But that is the first scenario and it seems still to be the scenario most people kind of think is going to happen, at least many of the panelists yesterday and this morning seemed to – the underlying assumptions seemed to be that.

The second scenario is really the disaster scenario. The financial sector plan doesn't work. There are big hits again in the financial sector. The banks are not safe by what's happening. The underlying two to three trillion dollars hole cannot be plugged by this private-public partnership. And the whole recovery doesn't take place and we actually are – continue to face the IMF still downgrading its growth forecast, this time for 2010, rather than 2009 as time evolves, and really the crisis is much deeper and much longer than we are predicting right now. I think the consequences of that for how we think about things and how we think about the world economy and institutions would be, of course, very, very important. And Santiago, for example, mentioned it. In Latin America – if that's the scenario, we will see very different events happening from what is happening right now.

I think there is a third scenario and I hate to make predictions. One has to be so careful these days. But there's a third scenario, which I think it's not totally unlikely, and that is that we will see actually some recovery, some aspects of recovery earlier than many people predict right now. And I think that will be basically because of the massive fiscal stimulus because it will push demand and will stem the decline. But that the underlying problems are not solved, that the banking issues are not really solved, and then after a certain kind of revival or apparent revival that may well take place this summer, that all of a sudden then there's a second decline. And that could be a third type of scenario. There may be other scenarios, but what I want to emphasize is that we're only six months into this and in terms of how this is going to play out, I think we have to be very careful and we should not forget that much more pessimistic or much more severe developments cannot be ruled out.

Now, the second point I'd like to make in the context of all this debate of where we're going – and this was said many, many times during the panels yesterday afternoon and this morning – is this issue of export-export led growth and a new model where the American consumer wouldn't be the driver of growth. And here I'm a little bit – I must say – confused between levels and rates of change, okay?

Let's assume that the American current account deficit declines this year from – by 4 percentage points of GDP to about one-and-a-half percent of GDP let's say, okay? Four percent of American GDP is about 1 percentage point of world GDP. Now, we could have a scenario where growth after that, just arithmetically – I'm not saying that would happen because there're dynamic effects and so on – but if American growth recovers and recaptures the past trend, then the one time shock to world aggregate demand will be of the order of 1 percent of GDP, the demand – and that's really nothing much.

We could have – if the first scenario I mentioned about comes true, we could have a world where two years from the American economy is growing at two-and-a-half percent, 3 percent a year. There has been a world recovery. And demand for exports of Latin American, Turkish, or Chinese goods will grow more or less at the rate they were growing before this crisis. So I don't think that the adjustment of the current account imbalances itself is necessarily a structural change in how the world economy proceeds thereafter.

Now, of course, if the world – if what people mean by there won't be anymore the American driver in the goods markets, if by that they mean that they don't believe that the U.S. economy will grow rapidly or significantly, then we do have a structural shift and I think that's what most people are really thinking about. But I just want to make the distinction between that and the correction of the current account deficit of U.S. as such, which could be a once and for all event and not necessarily translate into a permanently lower growth rate for the demand for exports from the rest of the world. And I think that has a – in term of the impact of this crisis on what will happen, I think this distinction is quite important.

Now, it is true that around the – throughout the world – again, the Latin American panel underlined it – things are really bad. Export demand is collapsing. Capacity utilization is going down, except for China and India and some Asian countries, but in the rest of the world things are really bad. My own country is a very good example. Average growth in Turkey of the order of 7 percent for six years and now the projection for next year, the official government projection is minus 3.6. Many people think it might be minus four, minus five. Capacity utilization is at the lowest level for decades, worst than during the financial crisis of 2001. And unemployment is much higher than it was in the last crisis. And yet, society as a whole doesn't seem panicked. And I think one of the reasons is that people say, oh, we saw this before. It happened nine years ago. It took a year and then we started growing again. So I think many people in the world are still looking at this crisis from that point of view.

Anyway, maybe I was too long, but I had to set this kind of context.

Now, in terms of governance, clearly dramatically international global nature of this crisis and therefore there's a very strong demand for governance mechanisms and changes in the fundamental governance. Now, here too I think a lot will depend on how things will play out. If 18 months from now things are more or less okay, the drama will not be very strong. But I do believe that the emergence of the G-20 is there to stay and that does reflect, I think, a deeper movement of economic weight to emerging markets and particularly, of course, to Asia. It's really Asia that if you take the weight in terms of GDP and so on that is dramatically

underweighted. But the informal mechanism of the G-20 has to be complemented – and this is one of the key points I want to make – by formal reforms in the actual decision making process.

If we take the example of the London G-20 meeting, the proposals that were adopted there, we call them decisions, the decisions really have to take place here, this week at the IMF board. It is the actual legally based international institution that can implement the kinds of proposals that come forward in the more informal context of the G-20, and I do believe, therefore, for the formal reform procedures – there's two more minutes – the formal reform procedures in the World Bank, in the IMF, in the U.N. system should not be forgotten when we discuss the way and the visible G-20 meetings which at the end of the day have no legal mechanisms behind them.

The final point I want to make in here is a big question mark and that is the following. We clearly have the IMF now being thrust by the G-20 and by the world community into a hugely important role again, only a year after people were wondering whether it would have any role at all, and a great deal obviously of concentration, of power, of influence, of finance in one institution. And here I think there is a very big and interesting debate. Is it – part of what we've seen is herd behavior in markets, people all making the same mistake, okay? And some people would argue that by concentrating so much power in one institution or in two or three institutions, institutions which have very similar staff, which are – and I come from them, so I'm part of that – where we think very much alike on many issues, where we influence each other, maybe these institutions are vulnerable to the same herd instinct that has afflicted financial markets. Maybe – so I think this is a question worth asking. What to do about it – Liliana says – maybe I have a chance to come back to that in the discussion period.

I don't want to – I want to end on this. I do believe, despite that question, that we need these institutions and there is no way to organize governance in a very decentralized way. Part of the problem with U.S. financial sector regulation is the segmentation of governance. So I do believe governance has to be by definition almost centralized. You can't have three, four different codes and legal systems kind of coexisting in the global economy in the financial sector.

However, we must find ways to counteract the herd instinct, the potential herd instinct within these institutions and to have feedback mechanisms from academia, from business, from civil society that are quite powerful and can challenge some of the reflexes in these institutions.

Last word – I was at the U.N. I think it was a wonderful period. I think Jose-Antonio will agree with me. The analytical capacity in the U.N. system compared, say, to the World Bank and the IMF is minimal and yet Asian crisis, as well as this crisis – and this goes credit to Jose Antonio and his colleagues – some of the predictions made by U.N. were much more on target than the predictions by the Bretton Woods Institution, despite the fact that the latter had 50 times more qualified economists and finance and so on. Why?

(Laughter, applause.)

MS. ROJAS-SUAREZ: Thank you, Kemal. Maybe excess qualification is a problem.

Justin, please?

JUSTIN LIN: Well, Kemal, to put that question makes my presentation very hard – (laughter) – because now I have to understand why.

Well, the title of this session is “New Approaches to International Cooperation and Institutions after the Crisis.” It seems that we are talking about new approaches, so I’m not going to talk about how to improve it because you try to improve the current institutions with current architecture and it’s our own, it’s not really new. And I’d like to reflect on what should be desirable.

And for this we need to understand the international development institutions. What’s their mandate? Well, their mandate, from my understanding it’s economic development, poverty reductions. And we know that whenever there’s some kind of crisis, it will be a big setback to development and also poverty reduction because we know every time you have crisis, some poor people need to pull their children from the school and they will – (inaudible) – that are going to have a long-term impact on them. So I think the mandate of the international development institutions should be development without crisis.

If they can achieve that goal, certainly they will be able to – (inaudible) – and facilitate the developing countries to catch up the high-income country. But development without crisis is that possible? Is that too ideal or not? So then look into the history. We know Japan from the 1950s to the 1990s, 40 years development without crisis. And they turn from a middle income country to one of the highest income country in the world. Again, Korea from 1960s to 1997 development without crisis, they turn from a low-income country, into again a high-income country. China, from 1997 to 2009, 30 years development without crisis and turn from a very low-income country now to be a medium-income country.

And during this period, they don’t have a financial crisis, but at the same time they did not have so-called modern, sophisticated financial institution either. They only have very backward banking sectors and so on. And not only so, we see some characteristics. Japan and Korea – (inaudible) – about 40 of development without crisis, they did not – (inaudible) – their capital account. They did not even encourage foreign direct investment into their countries. And China did not liberalize the capital account. But China certainly is something different, encourage foreign direct investment.

In any event, if we’re looking into East Asian experiences like Thailand, Malaysia and so on, they all have about 20 years of rapid development without crisis and here they – (inaudible) – their capital account. And I think that this is something – some experience that we need to look at very carefully.

And here I’d like to propose a hypothesis, how to develop without crisis. We know economic development means continuous upgrade in industries, continuous upgrade in technologies. In a poor country, how to have a continuous upgrade in technology and industries without crisis? I think the most important principle is to develop along the lines of compare

advantages, starting with something at early stage that don't have capital and so they develop something very resources intensive or labor intensive. And – (inaudible) – from labor intensive, resources intensive then gradually move up the – (inaudible) – to more technology intensive, capital intensive.

And during this process it is a continuous import substitution. They first identify some kind of product. They should have competitive advantage, but not the import. So they started to do import substitution produced by themselves and gradually turn that into export, step by step. And they're doing this process because their industries are consistent with their competitive advantage, so they are very competitive and they are very profitable. They cannot – (inaudible) – capitals. (Inaudible) – a capital accumulation, they upgrade their industry step by step, technology step by step. And in this process, because they are consistent with their competitive advantage, certainly they are export oriented.

At the same time, because they are consistent with the competitive advantage early stages labor intensive they create a lot of jobs. And so more people can be involved in the process, earn their income. And in this process capital gradually from skills turn into abundant labor from abundant turned into (superlative ?) skills. Much greater increase and so they can have growth development with equity.

And in this model you can see, actually, you don't need to have foreign capitals. You can accumulate your own capital and growth, and so you can avoid a lot of crises related to capital growth. And that is the model of Japan, the model of Korea during their development without crisis Japan from 1950s to 1990s, Korea from 1960s to 1997.

China is something different. China encouraged foreign direct investment, but the difference is that Japan and Korea maintained 10-percent growth rate for 20 years without access to foreign direct investment. China now maintained 10-percent growth rate for 30 years and I think the possibility for that is because China get access to foreign direct investment. But if we're looking into the foreign direct investment, it's all considered with the comparative advantage of China to use – (inaudible) – abundant labor so use China as exporting based to export those kind of labor intensive industries. (Inaudible) – get into the Chinese market, assemble those products in China – again very labor intensive. And I think that's the reason why that growth without crisis and not necessary to (liberalize ?) the capital account.

And in fact, capital account liberalization need to put a big question mark because many countries develop very well and once they liberalize their capital account, they started to have crisis. The reason is that for a developing country, capital is skills. Certainly if they want to upgrade their industry, their technology, they need to have capitals. And if you get access to foreign capitals, you can upgrade your industry faster, technology faster and to sustain the growth faster. My comparison between China and Japan and Korea demonstrates that.

However, we know that capital is just like water for the growth of a plant, right? You need to have water to grow. But if you have too much water, then you're going to have flood. And if you have flood, after the flood you're going to have a drought. Under that kind of situation, the plant will die, right?

In any effect, when you open your capital account, especially after you follow a period of growth, you are going to attract a lot of capitals because they think that you grow so well. So a lot of capital comes in. It becomes a flood. And then you will turn in to the bubble in equity market, in housing market. And that bubble bursts, all that capital going out and you are going to have crisis. And you are going to have a lot of volatilities in the process of development.

So with this understanding, I'd like to propose what is the new approach to international cooperation of a kind of model that is the nation, not development institution should promote four principles. The first one is knowledge, but knowledge from the view of the developing country. Try to understand what kind of industries can facilitate them to tap into their competitive advantages. Try to understand what kind of institution can help (the real ?) sector to tap into their comparative advantages. Try to understand what kind of – (inaudible) – could they have. They become a barrier for their economy to tap into their comparative advantages.

I'd like to use one example. I know have few minutes, but I want to borrow five minutes from you – (laughter) – because it's so important. First, when I talk about these ideas, give money to financial institution. For example, now we must think that developing countries should develop. The modern financial institution equity market – (inaudible) – market big banks like the developed country. But the question mark is that for the developing country in the early stage most of their operation are in agriculture – (inaudible). What's more, medium size enterprises. For those kind of real economy, equity market will not help. Bum market will not help. Big bank will not help. An – (inaudible) – portfolio flow will not help. What can help them is some small and then medium size local banks. However, according to our understanding, those small and medium size local banks are too backward according to our understanding. So we need to change them – (inaudible).

Secondly, we need to (facilitate ?) trade liberalization, globalization, because if the developing country wants to develop according to their comparative advantages, certainly they need to engage in trade and especially in agriculture, especially in labor markets. And they also – international financial institutions also need to facilitate the long term capital flow, foreign direct investment. I think the foreign direct investment in general will be in areas either of the developing countries bottleneck like infrastructure, or in area – (inaudible) – developing countries comparative advantages.

And the last one, the international financial institutions should engage in countercyclical lending. We know even the model I have, if it is in a globalized world, they will be affected in the real sectors, just like many developing countries now. They don't have any exposure to the financial sectors, but they are affected by the real sectors. And under that kind of situation, it's very important to have a countercyclical lending. And we need to improve our operational guidelines to make this kind of countercyclical lending possible. And with that I think it's possible to make all kinds of development without crisis.

Thank you.

(Applause.)

SEBASTIAN MALLABY: Well, that too was actually a great springboard for what I'm going to say. I'd be interested to follow after this and see how much we agree and how much we don't agree. But the first point I want to make in the context of the discussion about new thinking in the financial crisis is that we always have discussions about new thinking when there is a crisis.

It's very that when the world is going well, we think markets work, including cross border markets, so discussions across board or governments sort of go into silence. And then when you have a crisis – '97-'98 or the current one – everybody talks about international architecture. It's striking to me when I think back about some of the things I was reading, even two or three years ago about the international swaps market for example, this was portrayed not only as a miracle of sort of cross border activity, which had come out of nowhere and grown massively, but also that the governance around the swaps market are sort of being magically self generating.

Some lawyers had written the contract that describe what is swap – how a swap would work. They have put it on the Internet and then people have started downloading this language to create bilateral contracts between financial institutions, which were global, which were growing like Topsy and no government had ever put its finger on it. And it was sort of like the growth – the early growth of the Internet, the growth which was sort of who gets what domain name was decided by ICANN, a group of IT professors, who sort of walked along the beach outside Berkley, California, and didn't have shoes on and this is how they were going to hand out on a scientific basis the domain names that would govern the Internet. Governments were not involved.

So it's these periods of euphoria when you get, eh, governance it'll sort of take care of itself. And then in the crisis we realize that markets actually are not always self organizing, cross border markets are perhaps especially not self organizing. We do need governance. We need it on a national level and we need it on an international level. And we realize that to neglect the few decent global institutions that we do have because there aren't that many of them and to let them shrink as was the policy with the IMF just until recently is crazy because there will come a bad day, there will come a time when we need international institutions. There is a deficit, a political deficit in globalization that's come out as eloquently written. And so we need to kind of remember that in the good times as well as the bad times. So that's the first point.

The second point is that in these bad times we tend to short of shoot to the opposite extreme. We talk about new ideas and some of these new ideas are important and some of them are bit too new, a bit too ambitious in terms of what real traffic will bear. So I think that the key thing in this environment is for people in this room and policy makers to figure out what's the happy medium. What is the attainable new agenda and what is sort of the unattainable thing which – (inaudible) – stub your toe.

So if you think back to the '97-'98 crisis and the debate that followed that, the idea, which was actually, I think, a pretty good idea, which did end up as a toe-stubber, was the idea for an international stand still mechanism, sort of international bankruptcy facility for orderly

workouts of sovereign debt crises. And if you remember in 2001 there was a lot of effort by Anne Krueger, then the number two at the IMF, to push this idea. I think on the substance she was clearly right, but she couldn't succeed and that's the message to all of us. That if we are proposing things now, we need to be quite sort of serious about what we're going to propose.

And so I would put – at the risk of being contradicted by one of the other panelists perhaps – I would put ideas of a sort of alternative reserve currency, a sort of magical new SDR and so forth, which are on the Chinese Central Bank's Web site. I would put this in the sort of interesting but not ready feasible categories. So I would prefer to concentrate the discussion elsewhere.

So where should one look at it? I would say that one of the big interesting shifts that we ought to be making in terms of how we think about international governments is that there already had been before this crisis a shift away from a belief in conditionality by the international financial institutions towards what was called local ownership, the country in the driving seat, et cetera. This shift, which began in the early 1990s, which was by the way not adapted immediately and instantly, so if you look at the conditions around the Indonesia package in '97 proposed by the IMF, with you should fix your clove monopoly and so forth, plenty of micro conditions in that.

So it wasn't an instant shift, but broadly from the early '90s to the middle of this decade there was a retreat away from conditionality on the argument that basically recipients of foreign assistance would not stick to them, that it was foolhardy and sort of arrogant for an outside institution to believe that it had enough political leverage on the finance minister in Pakistan or wherever to really change that finance minister's behavior. It just wasn't a good trade. So you could look through the history and see how many times Pakistan has signed up for the conditions that it would shrink its budget deficit or whatever and it would renege on this commitment every time. So that – (inaudible) – there was a shift away from the conditions. There was a belief that – not necessarily that they were sort of wrong, but that they just wouldn't work.

Now, I would say the interesting thing is that we have a whole new set of reasons for being against conditions. And these are that they simply drive borrowing countries in the middle income and in the poor world away. And the most spectacular example of this is the way that, I think, partially out of frustration with IMF conditionality in the '97-'98 crisis, there was this massive reserve accumulation in emerging markets, a massive official sector build up of dollar savings. And I'm sure we can debate this in the panel, but my view would be that these imbalances did contribute to the financial crisis. They essentially meant that capital was whooshing into the rich economies. It was pushing up asset prices. And ultimately it stoked a bubble.

Could U.S. authorities have done more to stem that bubble? Yes, of course, they could have. Monetary policy should have been tighter and the supervisory function and so forth that could had been more done to prevent excesses in the U.S. financial system. But nonetheless if you have a very, very large amount of cheap capital coming into your economy, the financial system is such that they will find – the money will find some outlet. There will be some bubble somewhere and it will pop.

And so I think that we've got a whole new reason for thinking that conditions are a bad thing. Insofar as they drove emerging markets to self insure, to not believe in IMF insurance because IMF packages would come with so many conditions and to really want to have your own central bank bursting with reserves so that when a tough time comes, you can pay yourself out and not be dependent on the IMF.

Now, if that's the case and if incremental reforms are better than sort of blue sky new ideas that we can't implement, I would say that it's very good that we are on the path. We are right. We are on the path towards this enlargement of IMF resources, coupled with a reduction in the conditions associated with the disbursement of those resources, so that you get a friendlier, more user friendly IMF with more resources that can provide an incentive for emerging market economies to think again about self insurance through central bank reserves and believe more in collective insurance, which is clearly much more efficient in terms of the capital that you use. If it's collective, like any insurance putting mechanism, it's going to be more efficient. And it's going to avoid these – repeat of this imbalances that we've had in this last cycle.

My worry is that if we do not implement this proposed expansion of the IMF and we do not get the money that is supposedly coming after the London summit and we'll see this weekend if it is coming, then a rational emerging market will say, gee, before I thought it was important to have central bank reserves, so that I can insure myself. Now I've seen quite how stupendous these financial crises can be. Therefore, my incentive to self insure is even bigger than it was before – particularly since I think that – I spent a lot of time these days talking to people about financial reform, financial regulatory reform within the U.S.

And the basic bottom line of that debate is that nobody has anything approaching a good answer. There are bits and pieces which can get you some of the way and reduce some of the risk, but the basic point is that whether you're talking about system risk regulator or what, it's going to tough to – and I think in a way we've created so much moral hazard in the banking system through the bailout of AIG and through other bailouts that essentially the incentive for large institutions that are too big to fail to go out and create another crisis has actually been strengthened by this episode.

So the rational emerging market, looking at what's just gone on, will want to self insure through massive reserve accumulation unless we really get this story of IMF reform correct.

So in conclusion, what does that mean as IMF reform? It means, as I said, getting away from conditions. It means increasing the resources, being willing to use the resources I think pretty much as Justin Lin was suggesting in a sort of countercyclical fashion, but it also means, I think, not just those carrots which would encourage emerging markets to like the IMF and to see it as a source of insurance, it also may involve some form of stick. That if you do not play by the rules of international system, that if you use an exchange rate policy that is likely cause your current account surplus to be very big, the amount of capital you export to the rest of the world to be very big, if you're in that zone, then we do want through some kind of international surveillance to discipline you. That's a difficult idea to implement. It's challenge of – we know that when countries have an exchange rate that the market wants to push down, the exchange rate

crashes. They have no choice. When the market is pushing the exchange rate up, there is no clear way of disciplining them. We will never get away from that, but I think there are some ideas of using sticks as well as carrots to get the IMF to be a better policeman, a better quarterback of the international financial system to reduce these imbalances going forward. (Applause.)

MS. ROJAS-SUAREZ: Thank you, Sebastian for keeping on time.

And Minxin?

MINXIN PEI: Thank you. I want to thank Frank and Nancy for inviting me to speak here today.

Every crisis has several stages and in one of them people begin to look for a savior, and I think nowadays China is often mentioned as a possible savior, not only of the current crisis, but also as being a country most capable or more or less relatively more capable in providing a leadership role in post-crisis international institutional rebuilding.

So my task here today is to question this very idea in general and also question a more specific proposal about China and the U.S. as being the G-2, which will be essential in providing leadership in post-crisis world.

If we want to get any answers about China's role in the future in international organizations, we have to look at China's past behavior in these institutions. And on this front, I think the record is not very inspiring because China has a very distinctive strategy, philosophy that determined its behavior in international institutions in the past three decades. First of all, its philosophy is very different. China's international diplomacy or behavior is really determined by its realistic, politically oriented philosophy, world outlook, which means China in these institutions tends to be quite low profile, reactive rather than active. It guards its self interest very jealously, but on the other hand would like to free ride whenever it can.

Also it has a very deliberative strategy in how to behave in these organizations. First of all, it does not want to antagonize powerful existing stakeholders, especially the U.S., so it tends to stay not on the front line, but behind the scenes.

Second, China is also very pragmatic. It views these institutions primarily as means of helping its domestic economic development. So to the extent that these institutions are not helpful, China would not like to get involved.

And thirdly, of course, China has until recently been a relatively poor country and did not have the capabilities for playing a very active role. The good news is that all these are changing. In terms of philosophy China is now viewing itself increasingly more as a more cosmopolitan and global player. It also has begun to understand the role of being a more activist player on the international stage. And I also have to say we have to credit the international community for putting the pressure on China as being a responsible stakeholder.

Also China's strategic thinking about its international interests is changing as well. First of all, China is no longer self-isolated country. It has expansive global interests. It has to increasingly rely on global institutions to defend its interests. And I think you have to place Governor Zhou Xiaochuan's recent provocative idea about using the IMF SDR as a super-sovereign, reserve currency in that context.

So I think China believes that international institutions can advance its global interests in the future. And also clearly China's capabilities have improved a great deal. So I think China is now really at a crossroad in terms of its role in future international organizations.

But now let me address the specific idea of G-2 because the G-2 was advanced as an idea by Brzezinski and others not too long ago. By the way, there's an article in the current issue of Foreign Affairs on this idea. I deliberately did not read the article so that I would not be accused of plagiarizing. (Laughter.) But obviously the Chinese are saying that all heroes think alike. So if my ideas overlap with those, please believe me that it's original, rather than a second hand.

On the surface, the idea for G-2 is quite appealing because on three sets of grounds, you can legitimately – you can actually make some persuasive case. First of all, China's capabilities, the world's largest foreign council reserve, the second largest trading power, and increasing importance in global investment, and finally in this crisis China's fundamental health. Economic health is fundamentally strong.

So there's a crucial role for China to play in terms of its capabilities.

And second, if you look at global issues going forward, from climate change, from redesigning global regulatory institutions and from addressing global imbalances, you have to have China onboard. If you don't have China onboard, these things do not get resolved. And of course, you also have to have the U.S. onboard.

And third is that what I call G-2 by default argument. If you look at other potential partners where the U.S. can work with, they're not in terribly good political shape. Japan is politically paralyzed internally. It cannot make decision – I'm sorry if I offend any people in the audience regarding that statement. EU is in equally deplorable shape in terms of its political decision making. And by – and of course Russia is too weak. By contrast, if you look at China's policy-making during this crisis, at least on the surface it appears to be decisive. It was the first to bring a significant stimulus package at the table. And it has actually some good ideas to talk about.

So these three sets of reasons tend to advance, strengthen the argument that you also have a G-2. But I will say that if you think more about the G-2 idea, it does not appear to be a really good idea for the following reasons. First of all, there is already an informal process between China and the U.S. of a whole variety of issues. So I will even claim that there is an informal G-2 going on. If you look at the level of engagement between China and the U.S., the range of issue they engaged in, they are – they touch upon everything. And of course if you compare with America engagement with China with America engagement with other countries, the level, intensity, substance is far more substantive. So a formal of G-2 is not necessary in this case.

Second is that if you look at – on the one hand you will have to be glad about this engagement process between China and U.S., but on the other hand if you look at the actual achievement, the record is pretty meager. You might even argue that the outcome does not justify the effort because over the last few years, despite intensity, the pace of engagement between China and the U.S. on many critical issues, there were no real substantive outcomes.

So a formal of G-2 may not actually make things better. In fact, it might make things worse because it can raise expectations to unrealistic levels. And certainly the G-2 will have hidden costs. First of all, America's current allies will not be very pleased – EU and Japan in particular. And second, how do we place G-2 in the context of formal international institutions? Will the G-2 effectively go behind the formal international process, strike deals between themselves, and then try to impose their desires to international organizations?

And finally, I will say that China itself is very ambivalent about G-2. The idea is more popular in this country than in China and that says a lot about the feasibility of G-2. China, of course, likes to be in the room with U.S. alone because that raises China's international status. But the more you think about it, the Chinese have more reasons to worry. First of all, its capabilities are still limited. It's a developing country with massive domestic challenges. So why should China, in order to take on international commitments, spend its scarce resources outside China's borders?

Second, China is also fundamentally suspicious of American strategy, American intentions. Is this a ploy to trap China in extensive, costly international engagement?

And finally, let's be very frank about this. China and the U.S. are long-term strategic rivals. They cannot – as long as they are long-term strategic rivals, they cannot really be an effective G-2. So this – I've done my job of shooting down an idea that sounds quite good, but it's clearly in my judgment way ahead of its time.

Thank you.

(Applause.)

MS. ROJAS-SUAREZ: Thank you very much. We are perfectly on time – kind of. We are going to do now – to allow the rest of the audience to give room for intervention, I'm going to have two rounds of questions that I'm going to be collecting from the panel as opposed to one by one. And then I will give the word to the panel and then I will open it to the general public, okay? So those that want to talk, please, from the panelists, they can raise their hand and I'm just going to take notes now and then – okay, Jose Antonio.

JOSE-ANTONIO OCAMPO: Yes, just a couple of comments which I think take – (inaudible) – across. But surely know Sebastian Mallaby – his presentation – actually the best way to do a countercyclical world macroeconomic policy is actually to do it the Chinese way with a global preserved currency. So – this is – so I actually think that Chinese put on the table

the resolution to this problem, which actually has come – has been coming back since the '60s or in a sense it was the original proposal of – (inaudible).

So I actually think that is a solution in anyway. But it has to do – this point that – that will also abide by Justin Lin's countercyclical role of multilateral financial institutions, but that has to do again with the point that Kemal pointed out, which I find very interesting and again has to do with Sebastian's comments, which is why is the Washington community in particular so – why does it lack diversity? Perhaps is because the White House is too close. What is the – the UN community's certainly diverse. If you go to Geneva, you'll find diversity of views. Geneva doesn't seem – the Geneva canton doesn't seem to influence as much thinking in the international institutions and the ones located in Washington, nor does New York. Actually New York seems to be more diverse than Washington.

So I really think that this shows one thing that is fundamental, which is the diversity of views within international institutions. It is not true that during the good times, the all ideas that were discussed – (inaudible) – they were somewhere, not in Washington. This idea – in international financial reform, for instance in the UN, we continue working for through the boom years, putting out ideas that were totally ignored in the Washington circle. So I think it's a question of Washington and the lack of diversity. I think Kemal has it right.

MS. ROJAS-SUAREZ: Thank you, Danny?

DANNY LEIPZIGER: I guess my question's for Justin, which is the following. Interpreted the wrong way, one could read your prescription as being autarchic kind of development, avoid capital inflows because they're risky, develop a whole bunch of domestic industries et cetera et cetera.

I wonder if that's really the model that Korea, for example, followed. I tend to doubt it. So I wonder if you want to nuance your prescription a bit so that it's not seen as that because we can't run these big trade surpluses without capital coming back in. So the question is how to manage it rather than how to avoid it perhaps.

MS. ROJAS-SUAREZ: Thank you, Larry?

LARRY DIAMOND: I don't know if this is on, but one of the things that seems likely to happen, not only as a result of this crisis, but just as a result of larger shifts in global output in power that had been going on for a long time is the acceleration of demands for a restructuring of really the decision making authority in these institutions, which hasn't really been addressed much. So I would be interested to have Kemal Dervis address this issue of the structure of the World Bank and the IMF, the voting authority and shares, the tradition of who leads these institutions frankly. Why should it continue to be a European or American? And I think this is likely to iterate with calls for restructuring the UN Security Council and so on. Power is – global output is shifting in a way moral and intellectual leadership is broadening, so it's seems like the formal structure of these institutions is lagging. The G-20 is an innovation, but it's still an informal institution. I'd also be interested in hearing you answer the question that you closed you're remarks with, if you care to do so.

MS. ROJAS-SUAREZ: Arvind. Oh, I'm sorry, I didn't see Devesh.

ARVIND SUBRAMANIAN: I was here for none of the presentations, so I'm sure you – maybe you've all answered the question, in which case feel free to ignore what I ask. I guess it's a question for Sebastian and Kemal, is that when you advocate governance reform to make the IMF governments consistent with economic realities, the kind of insiders say, well, do all the math, nothing really changes. China gets a bit more. India gets a little bit more. But so what, what's the big deal? How is it really going to affect the way the fund is going to be run? And so that leads to my question, which is that the IMF approach now is that the problem was conditionality and I think Sebastian you may have said that the problem was conditionality and therefore it was let to insurance – (inaudible) – so forth. And now so the IMF is saying, okay, we reduce the conditionality to make it more attractive.

But let me give you an analogy with India. The planning commission gives money to the states, right? And for the discretionary money, it gives it tests to and sets tough conditionality. So the problem is not so much the conditionality, as the fact that old – (inaudible) – it's within a shared participatory framework to which everyone agrees to. So the question is, isn't that a parallel with the IMF that it's not so much light conditionality as a sense that everyone has that this is our institution, the governance and participation is fair and equitable and that's the real problem? And that's the case for expedited governance reform.

MS. ROJAS-SUAREZ: Devesh?

DEVESH KAPUR: I was a bit puzzled by Sebastian's sort of argument that the '97-'98 crisis led sort of developing countries, especially in Asia to build up their reserves and that contributed to the global sort of imbalances which contributed to the – (inaudible) – crisis. So you praise the role of the IMF actually in creating this crisis, and yet it is the very same IMF you want to empower with even more resources.

MS. ROJAS-SUAREZ: Okay, I would like the panel to quickly focus on what they can on each of the questions. So I'm just going to go and start in reverse order for answering what you think is applicable to you. So Minxin Pei, please.

MR. PEI: Well, none of the questions was addressing to me. So I'd say – (inaudible, off mike).

(Laughter.)

MS. ROJAS-SUAREZ: All right, Sebastian?

MR. MALLABY: I know the – (inaudible, off mike) – so I will take the challenge. So let's start with Devesh's point, so that's a decent – I'm sorry, okay. Now, you can hear me? So Devesh's point first. That's a decent point. If IMF conditionality last time was at the root of some of the evil, why you want to give more resources?

Well, I think the answer is that it should be conditional upon them being less conditional. And if they're not – if they weren't, if there wasn't movement in that direction, I suppose I would have a lot more reservations. I think that even if they say they're going to be less conditional, you will be well within your rights to say I don't believe it. It's basically a Washington institution. These guys always end up putting conditions and so forth. And then I would say, well, all right. But what's the alternative. If the alternative is that we have no International Monetary Fund and therefore no collective insurance, isn't that leading to a world of more country by country reserve accumulation, which is not the world we want? And the more that global capital flows are big, the more the incentive for self insurance is overwhelming and the more that imbalances are a problem.

So I take your point, but I think that we have no way of escaping the logic that we need some kind of IMF and the answer therefore is to argue about fixing it, improving it, not closing it.

Let me see what else – on Arvind's point. Yes, I agree that governance reform is important. I think you – I think that you'll never get to a position where your analogy with the federal structure of India is actually remote and irrelevant there. There's always going to be more of a sense of buy-in within a nation state system, of course, than there will be with a multinational organization. But nonetheless at the margin, I agree that governance should be part of the package of carrots that you need to get buy-in from middle income countries to make them feel this is their institution. And so with that in mind, I agree with Larry Diamond that it's high time that the leadership of these organizations was democratized, was not restricted to Europe and the U.S., and that's got to be part of the agenda for making people feel that these are their institutions, otherwise they wouldn't use them and therefore we'd be back to the problem.

On the SDR – let me just – I want to say one other thing on governance reform there. I do think when it comes to the World Bank, and I'd be interested to know what Devesh thinks about it, since he's the real authority, but it seems to me there's two issues. One is showing out the governance power more equitably. The other is how much heavy handed country governance do we want? I think the resident board of the World Bank is a nightmare. And if the World Bank is slow and if it takes forever to do projects and if therefore countries would rather go elsewhere to financing, it's because you have a resident board that meets there two or three times a week and is constantly asking questions and they spend their life preparing these board document. And they have to be – every T has to be crossed and – just – you could not run any company with a board that sort of sits in your office and meets several times a week and demands answers to all questions.

And by the way, behind the board, there're all these finance ministry officials in Paris, in London, and wherever else. And those guys in Paris and London are very clever and they're – (inaudible) – and they send questions to the board in Washington. And the board gets these questions and says, "yes, sir," and they go and ask their staff. And there's no actual off switch for this governance system, is just constantly asking questions. And I think therefore in the context of the governance reform, one wants not only to democratize which country's got a say, but also essentially to have a non-resident board.

Let me just quickly say on the question of Washington and the evils of Washington. I must say, living here, I don't feel there is a consensus on everything. I think two things about the Washington consensus. If you look at Congress and you say does Congress pass things very easily because they would agree on everything? One would answer no. They have gridlock. There is plenty of argument going on here. And so I think history is not so much that Washington is therefore – I think politicians, political systems more generally have short attention spans.

I actually agree that the American political system is worse in that respect because you've got this two-year cycle in congressional elections. You've got extreme checks and balances where in every individual is checking and balance onto his or herself and can pull things and block things and delay things. And so this creates massive extended delay. And in this environment is very hard to get anything done. And therefore people will look over the horizon and do things because their statesmen are quite hard to find.

So to that extent, I agree with your position on Washington, but I think basically the point is that whether you're looking at this political system or others, there's a tendency to forget the problem when the good times return. And so I also, in my little center at the Council of Foreign Relations produced a paper on IMF reform in 2007 that did not receive massive press. So I empathize with the issue that there were people saying this, but my point is that in political – in terms of people who count politically that was my point. This – in political circles debate about international architecture falls off the radar. I don't like that, but it's a fact.

MS. ROJAS-SUAREZ: Justin?

MR. LIN: Okay, the first one is Jose-Antonio's question about diversity of view. And I think it's very important. But from my understanding is not – it's not a problem at the World Bank. You know that Danny is the vice president of PREM at the World Bank and the vice president of – (inaudible) – at the World Bank and you can see our views are quite different. And it might be a problem across the street of the World Bank and that's the reason why I try to – (inaudible) – some rethinking about the approaches. And the second one about the Danny's question further I'm promoting some kind of autarchy models, certainly not because I'm promoting – (inaudible) – comparative advantages. And if you want to follow your comparative advantages, certainly you should begin then open globalized system. Thank you.

MS. ROJAS-SUAREZ: Thank you, Justin.

Kemal?

MR. DERVIS: Well, I really do believe that one has to navigate this tension between the need for unified – harmonized, not a single regulator, but a harmonized regulatory system of rules, calls, approaches, and the need for diversity. Both are there. As I said, one cannot have a regulatory system that's totally fragmented.

In terms of the diversity of views and the answer to my own question, I tend to agree with Justin that there's much more diversity in the bank than in the fund traditionally, maybe

changing slowly. And I think part of the problem, not so much perhaps Washington as Jose Antonio maybe suggested, I think there's a lot of pure financial sector logic which comes, by the way, from central bankers and finance ministries worldwide. So it's a particular view of looking at the world that permeates the IMF's mode of functioning.

And what I think would be needed in this global governance mechanism is really much more multidisciplinary and multi-background work that however hopefully can be of high quality because the danger, of course, is that everything becomes general and then nothing is hard, analytical, and facts based. But I think something which brings in specialists from health and from education and from politics and history into the real decision making of – or the influence on the decision making at least of the IMF I think would be very useful.

Now, there're two good things here. One I think is that the G-20 is evolving towards a leaders' G-20, not just the finance ministers' G-20. I think that distinction is important if it lasts. And second, there have been proposals to really encourage and input a feedback into the IMF's board and IMF board of governors and so on of a multidisciplinary group of specialists, of eminent statesmen of – and so on, not in a decision making capacity because that would be unrealistic, but a kind of a formal feedback mechanism that opens the field to a much more multidisciplinary way of looking at it. I think part of this crisis has come from the dominance of the finance sector in so many ways. Forty-two percent of corporate profits in the U.S. in 2007 come from the finance sector and very centralized three rating agencies actually, when you think about it, worldwide, three rating agencies really being the kind of regulator of this huge financial sector, and I think that's part of the bubble.

MS. ROJAS-SUAREZ: Thank you, Kemal. Before opening to the public, let me use the advantage of sitting here to ask a question that I would like Justin and Sebastian to answer. We've been all talking about the usefulness of IFI and the IMF's specifically countercyclical role. Now, it's very easy to think of that role in a world with – where countries have limited capital mobility or limited capital account. Now, let's go back to what happened in these days. Many, many emerging markets have chosen to play huge and heavy in the international capital markets. Okay, how can the IMF and IMF would lower conditionality such that will be effective in playing a countercyclical role?

The market is going to know the new rules of the game. The resources for the IMF would have to be huge because otherwise the market is going to say, okay, the moment I see – (inaudible) – in this context, I know that the IMF is going to come and provide the resources which will actually weaken the incentives of the countries to do well in terms of economical stability. If that's not the case and the market anticipates that the IMF resources are not big enough, well, they're going to shorten the currency, the – whatever assets to countries, even these institutions will not be effectively being able to play a countercyclical role, okay? So it's very clear to understand that for the IFIs to be effective, the amount of resources has to be huge. Actually, right now, the IMF – the market is trying to second guess or to guess what is the IMF doing with respect to Hungary and the Ukraine. If the money goes to the Ukraine, as promised, okay the market is there. Okay, you're bailing the country out, so fine. But if not – (inaudible) – to shorten the currency.

So it's easy to talk about let's have the IFIs being countercyclical, but are really the resources there given that the country has chosen to play in the international capital markets. Justin and Sebastian, can I have your views?

(Laughter.)

MR. LIN: Very good questions, but you know what I try to promote is development without crisis, development without the need of the – (inaudible) – to have countercyclical roles. Because if the developing countries follow my approaches, they are going to be very competitive and they have self insurance because their fiscal production is going to be very strong. Their frame reserves is going to be abundant and even they were affected by shock outside. They can have – come with a space to do the countercyclical role by their own government. That's one thing. And the second, the modern world not be perfect, but most countries follow their comparative advantage, certainly the needs will be much smaller. And if the needs is much smaller, your question disappears because your question is that the need's so huge – (inaudible) – international financial institution will not be able to meet that kind of demand.

If the need is small, then certainly the resources will be available, will be – can be managed. And especially if the international financial institution can use this kind of countercyclical function well and to invest in areas which are the bottleneck of the growth for the developing country. They make in general very high return. And so the function of the international financial institution can leverage the private sector's fun to make those kinds of investments because it provides some kind of knowledge and insurance. So – (inaudible) – that way, your question will disappear.

MR. MALLABY: Okay, I'm going to tell a little story and then I'm going to take issues like Justin said.

So the story is this. So in the depths of the Asian crisis, George Soros went to South Korea. Kim Dae-Jung, his friend, had been elected. This was January of '98. And he showed up and he basically pretended to be the IMF. He hadn't – (inaudible) – the Korean because he was tired of being called a Nazi speculator. So he showed up instead and said, hello, I'm from the market. I can tell you how do deal with these markets. Here are the things that if you do them in terms of economic reform program, you'll get cover market confidence. The money will come back and then you'll be better off.

Then Bloomberg did a study of how many times people downloaded Soros' remarks, relative to how many they downloaded the remarks of official leaders at the time like Bob Rubin. And the answer is they looked at what Soros had to say a heck of a lot more. And the market response to what Soros said was rather bigger. And the point of this story is that basically I think by the time of the Asian crisis and certainly now markets are recognized to be the disciplining forces on the macro-policies of emerging market countries. The old role of the IMF of saying, okay, we'll give you the imprimatur and if we say your macro-policies are good, then they're good, then the private capital will come in.

That has been overtaken by the fact that lots of hedge funds have their own view of what economic policies make sense and they're pretty similar actually to the IMF views because they hire similar types of people, but they reached these views quicker and they back it with their own money very, very quickly. And so the – I think the traditional role of the IMF in that sense was sort of superseded, but what was not superseded is that markets have – (inaudible). Markets go from one extreme to other, as Justin exactly rightly said, with respect to the analogy of the drought and the plant. If you water it too much, there's a flood, and then suddenly the flood is followed by a drought. You get a sudden stop in these financial flows. And so the residual role of public sector institutions like the IMF is not to be the seed of good asking the approval. It is to provide capital in a countercyclical fashion. And we just have to face that.

Now, how much capital? Danny asked a very, very good question, how much capital? Is it feasible that given the size of these cross border flows we'd have a big enough IMF? I'd like to turn that question around and say, okay, we've got these big flows. What are we going to do about it? Is the answer that we're going to do nothing in the public sector? I don't think so. Look at the way that the Federal Reserve responded early on in the crisis, last year, by providing bilateral swaps, \$100 billion a time to different central banks. So the point is that the governments of the world are not going to sit around and do nothing when the world economy's melting down.

The only question is, do we deliver these countercyclical resources through bilateral swaps from central banks or do we deliver it through a sort of centralized credit union like the IMF? And I think when you put the question like that it's obvious that we ought to prefer more of a collective answer because ultimately it's not a very good solution for the federal reserve to become the lender of last resort for all central banks around the world. Imagine that the hegemony, the sort of feeling of U.S. dominant – it's just – it feels bad. The political backlash that will follow from it I think is fairly certain. And it's just a more efficient way of doing it to do it in – if we didn't have the IMF, we would be looking at what the fed has just done and say, gee, no, we want to collectivize this. We ought to make it international. Let's invent something. We'll call it the IMF. So I really do think that if you ask the right question, are the resources going to be big enough?

But if you turn around and say, we have this problem. Global capital flows are very big. Will we do nothing? No. If we're going to do something, do we want to do it nationally? No. Therefore we will do it collectively. Yes. Therefore we need to make the IMF very, very, very big. I think that's the answer. And the big news can come and be designed in different ways through contingent lines to the IMF from governments or people can think about that.

But I think the fundamental point is that – now, let me just disagree with Justin on one thing. Here's the point. Justin's been talking quite eloquently about development without crisis. I would like to suggest that the danger is that his model of development is development with crisis because is development without a crisis taken on a national level, right? So if you are looking at it from one country's policy making point of view, yes. Huge reserves, you protect yourself. That's development without crisis.

But now I think about the global implications for the system. If everybody has that policy that they want to create huge reserves, somebody has to be on a deficit position on the other side of that, so you will get masses of capital flowing into these deficit countries and they will stoke another bubble and it will be a crisis. It won't be development without crisis. It will be precisely with the crisis because China is too big to be doing this and lots of other emerging economies have grown too big to be doing this. And so I'd be interesting to see what you think about that.

MR. LIN: That's – (inaudible) – question. Yes. I think – we say grow for imbalance. But actually the growth – (inaudible) – always balance, right? Someone steps in and then the other one must use it. The question is how you use it. If you use that – (inaudible) – consumption, then you – (inaudible) – debt and then you won't have the ability to repay. Then that becomes a crisis. If you use those kind of money to make an investment and that investment will generate – (inaudible) – future, then there will not be crisis. So I think the question is not that some country cumulate the reserve, is that those – (inaudible) – other country how to use it. And as so – if everyone uses that investment way, then I don't think it's necessary to be a crisis.

MS. ROJAS-SUAREZ: Kemal?

MR. DERVIS: Just very quickly on – that is actually one of the arguments for SDR – regular SDR allocations, of course, because there could be a mechanism to increase reserves without needing the current account deficit of a particular country. So I think – just that's a rejoinder to what has been said. And second, ultimately, it's really – Anne Krueger's point. It's really a fiscal issue. The consolidated central bank and treasury account has to have sufficient reserve in it to be able to be countercyclical. So I think those are the two kind of points that one could inject into it. But then, going on Sebastian's point, if we're going to have this huge IMF playing that role, including perhaps with the SDR allocations, then of course the governments of it and the fact that, as Sebastian said, that it has to be perceived by the world as our institution, not somebody else's institution becomes all the more important.

MS. ROJAS-SUAREZ: Okay, I only have five minutes from questions from the audience, so let me see. I have one, two hands. Last call for third hand? Right there. That's what I'm taking. Okay, please. Identify yourself please.

Q: Bob Aden (ph), USAID. I was in Indonesia during the 1997 crisis. I'd been there for some years working for USAID. And so in Indonesia the power and the society was nicely balanced between reformers with the support of the IMF and USAID and all the rest and a set of people who were really opposed to reform. And that brings up a question of the impact that I think the IMF program had, which was to help the reformers move forward with a set of issues against the folks on the other side. And the issue is doesn't it – does it matter at all with respect to the judgment that was reached there was this kind of internal issue within the Indonesian government?

MS. ROJAS-SUAREZ: Okay, the second question on this side right there.

Q: Thank you very much. My name is Peter – (inaudible) – I come from Dar es Salaam, Tanzania. I want to bring practical examples here and I wouldn't agree the financial institutions are for development and poverty reduction. In Tanzania, IMF labeled Tanzania as a mature stabilized country with a growth of 70 percent. Poverty reduction in seven years, 2 percent. In fact, there are more people poor now than there were in 2001. Having said that, I would like us to look at IMF beyond providing loans.

IMF in a number of countries do provide what they call policy-support instruments. They have a huge power into deciding whether the country get resources from other countries or not. When they decide whether these policies are feasible or not and they – (inaudible) – the countries to provide loans. What IMF does in principal, restricting the national budgets and restricting spending in the social sector, it does reverse a number of sectors, education for example, how to create quality labor if your education system is not strong? Health, for example.

Now, in this case what I want to point out is that the role that IMF has is much more beyond than it should have and we do not have history that tells us that countries that were abiding to IMF policies did make substantial progress for example. And I think it is time to look at the mandate before we give money, before we give these roles and responsibilities to look back and say how effective and how efficient it has been before we say we give them billions of money.

So my question is, is it really relevant, especially on the policy support claiming to understand poverty – (inaudible) – in the countries than the countries themselves? And transparency has been discussed again, discussed with the ministers of finance alone and making them say these are poverty reduction policies. Thank you.

MS. ROJAS-SUAREZ: Okay, thank you. Last question, there.

Q: Hi – (inaudible) – from Voice of America. I have a question about Chinese economy. Not too long ago, everybody was downgrading China's economic growth forecast, but I think as recently as yesterday several forecasters like Goldman Sachs are upgrading their forecast for Chinese economy. But there're also economists who are arguing that it's too early for the stimulus package to take effect yet. They also argue that with this massive bank lending engineered by the Chinese government, of course, you're going to see some recovery in the economy, but they argued this is going to be temporary because it's not sustainable and there's also – (inaudible) – efficiency. So I'm just wondering what you think of that.

MS. ROJAS-SUAREZ: Okay. Could I have a very quick point in response to the – from whoever wants to take the questions?

MR. MALLABY: I could do one on the first two, which is simply to say that is an interesting pair of question because the questioner from Tanzania was saying the IMF conditionality is terrible. And the question about Indonesia is saying, isn't there something to this because you push in favor of the reformers? I would say that the pair of questions demonstrates that the conditionality is massively unpopular and therefore there is a collateral

cost for the IMF's ability to act with legitimacy all around the world and we've ripped the harvest in this crisis and we can't afford to do that again.

MR. LIN: Sebastian answered to – (inaudible) – so I can answer the easy one, the growth rate in China. According to the Chinese government – Chinese government still thinks it's possible to achieve 8 percent growth rate. It's a target. And the World Bank and IMF forecast the growth rate will be 6.5 percent. And personally I think it's most likely between these two figures. (Laughter.) Yes. And it's most likely between seven and eight from what I see.

The reason is that we forecast a 6.5 percent based on the information we have now. But we know Chinese government is very responsive to the changes, to new challenges. And they already announced a stimulus package. And they will see whether it works or not. And – (inaudible) – why is not sufficient. I can expect maybe later this year in August or in September the Chinese government may introduce the second package and by that I think it's likely to be beyond 6.5 because 6.5 is based on the stimulus – (inaudible).

MS. ROJAS-SUAREZ: You want to say something, Kemal?

MR. DERVIS: No, just to say that while the old style decoupling is obviously wrong, we do have a new kind of decoupling in terms of the difference of the growth rates among various economies. So clearly if China grows at seven and U.S. is minus two, this is kind of a decoupling.

(Laughter.)

MS. ROJAS-SUAREZ: Well, with those final remarks, I want to thank all the panelists for a very, very interesting discussion. Please join me in thanking them. (Applause.) And before you leave your seats, Francis has an announcement.

FRANK FUKUYAMA: Okay, we have to clear the front part of this room to get set up. There're going to be TV cameras and other things coming in for the keynote address. The title of that is "Multilateralism and the Role of the IMF in the Financial Crisis." Dominique Strauss-Kahn, the managing director of the IMF will be here at 1:30. We have box lunches at the back of the room, but I would ask you to take a lunch, but to try to move out of this part of the room as quickly as you can so we can rearrange the seating. Thank you very much. At 1:30 – the address will be at 1:30.

(END)