TASKS IN BUILDING A NEW BRETTON WOODS

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Domestically, the main task will be to regulate the financial system internationally, to set limits to current account deficits - limits agreed internationally.

In the next days, the political and economic leaders of the major countries will meet to discuss a new Bretton Woods. They will also profit the opportunity to review the main policies that were already adopted to guarantee the commercial banks' solvenc y and to increase the liquidity of the financial system. The essential decision on these matters ndash the capitalization of banks ndash has already been taken, but, given the natural mistrust of the banks, the reestablishment of financial flows is taking more time than it would be desirable. In the United States, the Federal Reserve Bank is actively participating of it. In other countries, similar initiatives are taking place, as, for instance, in Brazil were the Bank of Brazil and the National Development Bank (BNDES) have increased their credit outlays.

Yet, in large part due to the irrationality of the stock exchanges wild reactions to small changes in the economic indicators, previsions about the real consequences of the crisis are becoming increasingly negative. For 2009, JP Morgan predicts a 0.5% GDP fall in the rich countries, and a 4.2% GDP increase in the emergent countries. Nouriel Roubini speaks of ldquostag-deflationrdquo. I have no doubts in relation to the recession that is beginning in the developed countries, but I believe that these previsions are over pessimistic. As soon as the policy measures that are being undertaken become effective ndash and they will ndash, most of the credit flows will be reestablished, and the reasons for a sharp retraction of economic activity will cease to exist. As it happened in 1929, the insolvency of economic agents, beginning with the households and ending with the banks engaged in subprimes will bring serious real consequences, but they will not be so burdensome because, differently of what happened at that time, the national governments acted fast and competently to neutralize it. Some mistakes were made ndash principally the decision to not rescue Lehman Brothers ndash but the over-all balance is positive.

Now, governments must and certainly will take additional measures to neutralize the real contraction. Besides reducing the interest rate ndash something that the Fed is doing since the beginning of the crisis, and the other central banks are gradually following ndash they will have to increase transitorily state expenditures. In 1929, some measures in this direction were taken in the Hoover administration, but they were timid stronger measures happened only in 1933, already in the Rooselvelt administration, but at that time the disaster had already been consummated, and the Keynesian policies were just able to avoid worsening the depression.

How will the covenants of the 15 November G20 meeting be able to design a really new Bretton Woods and not just make a patch in the global disgovernance that is developing since 1971, when the original one was abandoned? A classical solution would be to come back to Keynes' proposals in 1944 ndash particularly the creation of an international money. Something may be undertaken in this direction, but today the world society is much more real than 60 years ago, although not yet prepared for substantially improving global governance the times are not yet reap for the first steps in direction of the transformation of the United Nations in a world government the global interdependence among people and organizations will have to increase much more before this happens.

Being less ambitious, it is basic to distinguish the credit that business enterprises need from the foreign credit to cover countries' current account deficits. As to the domestic credit, three things are essential: first, after the crisis broke up it is becoming consensual that the necessity of a more tightly regulation of the banking activity if commercial banks cannot go bankrupt without causing systemic risk, they are a quasi-public activity that must be fully accountable. Second, the adoption of policies, by the governments, to reduce financial disintermediation ndash i.e., the concession of credit by non-commercial banks. Banks are the institutions adequate to supply credit besides the expertise, they have the capital structure required to back lending. Investment banks are a wonderful invention, but they should be tied to large commercial banks. Other agents like mutual and hedge funds will continue to exist, but active financing and leverage including the one arising from financial derivatives should be limited. Third, the necessity to limit the concession of bonus to financial agents besides lacking minimum moral legitimacy, they are a major source of irresponsible, short term, speculation.

In the international level, the main task is to avoid that developing countries fall in balance of payment crises ndash a kind of financial crisis directly caused by current account deficits ndash the so called ldquoforeign savingsrdquo. In Bretton Woods there was not this concern it was assumed that developing countries would need foreign loans to finance their initial growth. One of the rationales behind the creation of the World Bank was to make true the policy of ldquogrowth with foreign savingsrdquo. Yet, since the major financial (balance of payment) crises that developing countries faced in the 1990s, it became clear to many of them, first that historically countries not grow with current account deficits or foreign savings, but with domestic savings what is necessary is domestic credit to business entrepreneurship, not international credit to countries. Second, that current account deficits financed either by loans or by direct investment usually only cause high rates of substitution of foreign for domestic savings, and balance of payment defaults such substitution rates are low only when the country is already growing very fast. The argument in favor of foreign direct investments is not that they supply capital to developing countries financing current account deficits, but that they supply technical expertise to them. This reasoning applies to middle income countries. Very poor countries will not have either sufficient domestic savings or conditions to create them. In this case, it is better to provide this country with aid, not with loans.

In the discussions of the new financial architecture, the creation of a really international agency ndash instead of an agency dominated by a few shareholders as it is IMF ndash will probably not be considered. The least one can expect, however, is that IMF's mandate and policies should be redefined. Its virtual possibility of issuing an international currency to support international liquidity shortages should be increased, but its central mandate should not be the rescue of the countries that default or are quasi-defaulting their debts, but to actively avoid that this happen. To achieve this preventive objective, it would be necessary, first, to convene among nations a maximum current account deficit in relation to GDP that would be allowed to countries and, second, to create a public alert system whenever a country surpasses such limit. The argument that this practice threatens the national sovereignty that today blocks IMF of acting in this way should be disregarded. In global times, the autonomy and competitive capacity of nations and business enterprises are more necessary than ever, but their financial transparency is a condition for global markets to be source of increasing wealth instead of recurrent crises.