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Joseph Stiglitz Leads Conference on Reform of Financial System, Prevention of Greater Social Crisis, and Greater Involvement of Developing Nations

NEW YORK—Nobel Laureate **Joseph Stiglitz of Initiative for Policy Dialogue (IPD)** was joined by over 50 expert academics, international regulators, banking representatives and policymakers from the US, Europe, Asia and Latin America to discuss the financial crisis, its causes and the future of financial regulation. Stiglitz was joined by **NY Federal Reserve Bank’s Senior Vice President Christine Cumming**, as well as present and past top economic authorities from India, Colombia, Spain, Poland, Germany and Brazil, also **Justin Lin, Chief Economist of the World Bank, Poul Rasmussen, Head of the Financial Regulation Committee in the European Parliament**, as well as **Jose Antonio Ocampo and Stephany Griffith-Jones** and others who met to send the outcome of their discussions to the G20 on November 15 in Washington D.C.

The financial crisis that began in the United States in the summer of 2007, and then quickly spread to Europe, has now become global and increasingly serious. Governments and central banks around the world have taken extensive measures, but have not been able to contain what is no longer merely a financial crisis. The threat of global recession and the dire social consequences that accompany such a downturn make it essential to pursue **internationally coordinated – but nationally tailored – significant expansion of fiscal spending** to maintain economic activity.

With numerous calls for the G20 summit to become a “Bretton Woods II” the challenge facing the group on November 15 is twofold: what is the agenda for Bretton Woods II, and how is the process to be made inclusive of all countries, and not just the G20? A global economic crisis requires a global solution, and this goes for financial regulation as well.

The conference participants agreed that the financial system should be a means to an end —helping fund a prosperous and stable economy. But mostly the financial markets did not do this, and developed financial innovations that lead to excessive and short-term profits. Instead of managing risk, the financial sector often created risk, as Professor Stiglitz argued. It is therefore essential to design good regulation that will lead to innovations that serve, and do not harm, the real economy. This would for example imply creating mortgages that help people stay in their homes, as well as instruments to finance future-oriented investment which would support the necessary structural changes in the economy, e.g. investments in low carbon technology.

There are three key principles for regulatory reforms that should be embraced. **1.) Regulation needs to be comprehensive**, covering all financial activities, instruments, institutions and markets, including bank off-balance sheet activities, institutions like hedge funds and offshore centers. Otherwise the “shadow financial system” will make it impossible to avoid the regulatory arbitrage that led to the current crisis. Regulation must imply both capital and liquidity requirements **2.) Regulation should not be complex, as complexity leads to opacity, which hides systemic risk, and any regulatory reforms should have a strong counter-cyclical focus** to prevent the excessive buildup of leverage and systemic risk during booms, and to strengthen financial institutions so they can keep providing credit during downturns. The Conference discussed effective counter-cyclical measures that have

already been introduced, such as dynamic provisions in Spain and investment fluctuation reserves in India. Similar measures should be applied in other countries 3.) **Given that capital is global, there is a strong case for a global regulator** to govern such a system. This regulator would likely be built on a well-functioning network of national and regional authorities. It is important that developing countries participate in the design of such a regulator.

Reform of existing or creation of new institutional bodies should flow directly from consideration of what functions need to be fulfilled by the new system. An inclusive, agenda-setting process is already in place. The United Nations' Follow-up International Conference on Financing for Development takes place in Doha just two weeks after the G20 summit. The G20 could take the opportunity to address its outcomes directly to the review conference in Doha, a process with the backing and close collaboration of the UN General Assembly – the “G192” – and the Bretton Woods Institutions.

For more information go to www.policydialogue.org

To download “Key Principles for Financial Reforms that G-20 Leaders Should Implement”
<http://www0.gsb.columbia.edu/ipd/programs/item.cfm?prid=133&iyid=13&itid=1555>

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