Panel 8 Financial prospects & hindrances

The collapse of Lehman Brothers, a sprawling global bank, in September 2008 almost brought down the world's financial system. It took huge taxpayer-financed bail-outs to shore up the industry. Even so, the ensuing credit crunch turned what was already a nasty downturn into the worst recession in 80 years. GDP is still below its pre-crisis peak in many rich countries, especially in Europe, where the financial crisis has evolved into the euro crisis. The effects of the crash are still rippling through the world economy: witness the wobbles in financial markets as America's Federal Reserve prepares to scale back its effort to pep up growth by buying bonds.

The industrialized countries of continental Europe generally faced severe economic problems because of the financial crisis, and most experienced an economic slowdown while mirroring those in Britain and the United States. France and Germany as well as other countries supported their banks with government loans. The global financial crisis has seen the largest and sharpest drop in global economic activity of the modern era. In 2009, most major developed economies find themselves in a deep recession. The fallout for global trade, both for volumes and the pattern of trade has been dramatic. The OECD predicts world trade volumes could shrink by 13 % in 2009 from 2008 levels[1].

Governments have responded with an reduction of monetary and fiscal policy that in turn have their own effects on activity and financial and trade flows. The downturn in activity is causing unemployment to rise sharply and, with it, a political response to protect domestic industries

[1] OECD 2009 http://www.oecd.org/document/12/0,3343,en_2649_37431_42788172_1_1_1_1,00.html

through various combinations of domestic subsidies and border protection. There is potential for protectionism to rise further.

It is now clear that the crisis had multiple causes. The most obvious is the financiers themselves—especially the irrationally exuberant Anglo-Saxon sort, who claimed to have found a way to banish risk when in fact they had simply lost track of it. Central bankers and other regulators also bear blame, for it was they who tolerated this folly. The macroeconomic backdrop was important, too. A "savings glut" in Asia pushed down global interest rates. Some research also implicates European banks, which borrowed greedily in American money markets before the crisis and used the funds to buy dodgy securities. All these factors came together to foster a surge of debt in what seemed to have become a less risky world.

The regulatory reforms can be seen as an extended mea culpa *by central bankers for getting things so grievously wrong before the financial crisis. But regulators and bankers were not alone in making misjudgments. When economies are doing well there are powerful political pressures not to "rock the boat". The long period of economic and price stability over which they presided encouraged risk-taking. And as so often in the history of financial crashes, humble consumers also joined in the collective delusion that lasting prosperity could be built on ever-bigger piles of debt.*

Although signs of improvement have appeared recently, recovery remains uncertain and fragile. The EU's response to the downturn has been swift and decisive. Aside from intervention to stabilise, restore and reform the banking sector, the European Economic Recovery Plan (EERP) was launched in December 2008. The objective of the EERP is to restore confidence and bolster demand through a coordinated injection of purchasing power into the economy complemented by strategic investments and measures to shore up business and labour markets. The overall fiscal stimulus, including the effects of automatic stabilisers, amounts to 5% of GDP in the EU.[2]

„Preparing exit strategies now, not only for fiscal stimulus, but also for government support for the financial sector and hard-hit industries, will enhance the effectiveness of these measures in the short term, as this depends upon clarity regarding the pace with which such measures will be withdrawn.

In the financial sector, government guarantees and holdings in financial institutions will need to be gradually unwound as the private sector gains strength, while carefully balancing financial stability with competitiveness considerations" (Marco Buti - Director-General, DG Economic and Financial Affairs, European Commission).

In this context, we are interested to attract valuable papers (exploratory research , case studies, comparative analysis etc) that may raise an interesting debate and generate ideas for future mutual cooperation between participants.

[2] Economic Crisis in Europe: Causes, Consequences and Responses, European Economy, 7/2009 – DC Economic and Financial Affair, Luxembourg: Office for Official Publications of the European Communities, 2009 http://ec.europa.eu/economy_finance/publications/publication15887_en.pdf