



Administrative Staff College of India
The College for Practising Managers



The Global Economic crisis: Challenges and opportunities for Public Administration

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Ideological Origins of the Present Global Crisis

- The present Global Economic Crisis had roots in a paradigm shift in mainstream thinking since the mid 1980s:
 - De-emphasizing the role of governments and the public sector in direct economic activity
 - Placing faith in smaller government deregulation and pursuit of profit
- The growth of market fundamentalism led to an unquestioned acceptance of the benefits of general and limitless financial liberalization.

What were the developments that led to the turmoil?

- *Globalisation of the World Economy*: while it spurred specialization and productivity gains across the world, it exposed many countries to greater vulnerability to global developments.
- Driven by *electronic technology* the greater role of markets and the magnitude of financial flows, a crisis now spreads more rapidly from one country to another, magnifying it in the process. The electronic technology that came into vogue has become both an asset and a liability in driving the crisis.

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- The *abolition of the Glass-Steagall Act by the US* in 1999 had the effect of inducing the banks to ‘play’ the markets for quick profit.
- A growth of ‘*short-termism*’ in decision making by banks and other market players. *Bonus-driven culture.*
- The *oligopolistic nature of credit rating agencies* in the US: three agencies – Standard and Poor, Moody’s and Fitch – dominated the market.
- *Adoption of sophisticated mathematical models* that did not allow for human error or human factors – such as ‘*irrational exuberance*’ or pessimism – resulting in herd behaviour in financial markets.

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- The growth of hybrid instruments involving a *bundling of securities* that lacked transparency.
- *Regulatory failure* in the financial sector: regulatory arbitrage; failure to develop proper procedures for assessment of risk in extending credit or undertaking investment in different types of assets (e.g. loans for housing or investing in foreign securities).
- The general *belief amount the regulatees that every law has loopholes*, and that they can get around the law.
- *Regulatory capture by major banks.*
- The nurturing of a false belief that some banks or investment institutions are *'too big to fail'* – *and that they will be saved with public subventions.*
- Exposure of banks to equity markets and cross-holding of shares by banks, with *'systemic stability'* exposed to risk.

How did Governments respond?

- Some countries relied on the role of government, the regulators and the public sector in containing the crisis. Examples:
 - *The Peoples Republic of China* affected a significant stimulus by way of investment in infrastructure and subsidies to consumers.
 - *India*: a significant presence of public sector commercial banks and the wise policies of the Reserve Bank of India (RBI) provided a great lever for the government in stabilizing the situation.
 - *Canada* avoided the worst consequences of the crisis through limiting leverage, protecting consumers, and being more open to the need for regulations.

Lessons from recent experience

- *Financial system needs to be monitored closely; a part of the financial system should be in the public sector that is not driven by short-termism.*
- The notion that some *'banks that are too big to fail'* is dangerous: it encourages them to take excessive risks. If some banks become too big, there is a case for big-banks specific regulation.
- In the contemporary world, while there is globalisation of finance, there is no globalisation of regulation. Opens the ground for regulatory arbitrage.

Build Trust in Government

- Recent developments have worked to undermine trust in Government:
 - Market fundamentalism leading to *sharp falls in the ratio of wages in total income.*
 - *The emergence of predatory self-interest in economic conduct,* with the consequent erosion of the underlying values of morality and ethics.
 - Failure to correct perceived deficiencies in regulatory regimes, or indeed overlooking violation of legislation.
 - The growing centralization of power in major corporations and in the executive wings of government makes the ordinary citizen feel helpless.

Build Trust in Government

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- Conclusion: The world should be '*highly skeptical of the benefits of general and limitless financial liberalization*' (Turner, Adair, 2010), and the shrinking of government and the public sector.

How can one restore trust in the Government?

- Strengthening of public administration through new laws and regulations cannot by itself will set the wrongs right:
 - The compliance with law is itself based on a certain common set of moral values and traditions: when these are eroded, it will not be easy to secure compliance to good behaviour by the simple act of promulgation of law and administrative rules.
- Public values – *transparency, predictability, and equality before law* – need to complement the individual values for achieving good government.
- There is a need to revisit, redefine and bolster the roles of government and reposition the public sector with a view to provide *stability, growth and restore faith in a just society*.

How can one restore trust in the Government?

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- But it is also important to recall that big governments with concentration of political and economic power in a few hands and agencies can lead to loss of freedom, innovation in government and public administration, and poor service delivery.
- When governments are the monopoly suppliers of services or goods, they often prove to be indifferent suppliers at high costs. There is thus a need for competition, decentralization of power and a healthy balance between the executive and the legislative wings of government.

Role of Civil Society

- In a framework in which neither the ‘profit motive’, nor ‘big governments’ are the overarching principles of social organization, there might be a place for *public-private-people partnerships (PPPPs)*, with a recognised role for civil society.
- Examples PPPPs include those schemes that have won *innovation awards from the Secretary-General of the United Nations* (e.g. WASMO from India).
- The debate should not be conducted in terms of public versus private sectors alone: it should transcend these categories to arrive at new, innovative forms of governance that fully take cognizance of the new polities that we live in.

Conclusions

- The global financial and economic crisis has brought into the open the issue of the role of governments and public administration in preventing such crisis in the future. *The assumption, widely prevalent, that we pause and reset the button, is neither borne out by experience nor safe to rely on.*
- The IMF, the apex body at the global level, to warn and advise on systemic risks associated with financial innovation and capital flows, was conspicuous by its absence. Its voting structure is weighted in favour of big countries that have seen a regulatory capture that fuelled the global crisis. And the other institutions proved to be too weak to rise to the occasion.

Conclusions

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- *The issue of who would and how to fund stimulus packages in times of deep recession also assumes great importance. Countries whose currencies form part of international reserves – e.g. the US Dollar, the Euro, the Yen, etc – have a degree of advantage in this respect; but the ability of other countries to intervene is limited by the need to earn these currencies through export surpluses.*
- Slide – The electronic technology that came into vogue has become both an asset and an liability in driving the crisis.
- *A way out is to have a global currency units such as the SDRs which may be issued and allocated to member countries following a formula that gives weight to GDP and volume of trade of member countries.*

Conclusions

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- *There may be value in having regional currency units also. Such a scheme will provide greater opportunities for a greater dispersion of trade creation across the world.*
- There is also the question of who should bear the burden of the rescue packages:
 - *Given the systemic importance of banks, and the need to deal with the problem of 'moral hazard', there is some value in looking to the commercial banks to fund some of these costs of intervention. (E.g. Proposal by the British Prime Minister for a global levy on banks that could be drawn upon by governments).*
 - *There is a need for new global forums that are more inclusive. (G20 is more inclusive than G7 – but there a feeling that it is a mechanism for co-opting the major developing countries in which the industrial countries predominate). The small states are left out of it.*

Issues for Discussion

- CEPA may wish to discuss:
 1. How can the international system be strengthened to anticipate and avoid systemic risk? Are the current financial and trade institutions at the international (IMF, World Bank, WTO, BIS) adequately geared to anticipate, warn and contribute to a reduction in systemic risk? How can the UN, that gives equal weight to all nations in its deliberations, play a greater role in this regard?
 2. What steps can national governments take to improve their capacity for preventing systemic risk? And when it occurs, address it quickly?
 3. What steps can be taken at a global and national level to prevent regulatory capture by banks and other financial players in the market?

Issues for Discussion

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4. What can be done to bring attention and give due weight to the policy decisions and developments in major countries that have a wider global impact? And how can the developing countries and small states be helped to establish mechanisms that can quickly and effectively deal with risks emanating from outside their national domains?
5. What steps can be taken to strengthen the role of the public sector in effectively dealing with emerging dynamic situations and the risks emanating from national and international developments? What steps can be taken to build the trust of the citizen in public administration in the industrialized developing countries, in the absence of which societies can descend into disorder and anarchy?



Thank You