Department of Economic & Social Affairs

DESA Working Paper No. 132
ST/ESA/2014/DWP/132

February 2014

Crisis mismanagement in the US and Europe: impact on developing countries and longer-term consequences

*Dr. Yılmaz Akyüz**

ABSTRACT

There are two major failings in policy interventions in the crisis in the US and Europe: the reluctance to remove the debt overhang through timely, orderly and comprehensive restructuring and the shift to fiscal austerity after an initial reflation. These have resulted in excessive reliance on monetary means with central banks entering uncharted policy waters, including zero-bound interest rates and the acquisition of long-term public and private bonds. This ultra-easy monetary policy has not been very effective in reducing the debt overhang and stimulating spending. It has, however, generated financial fragility, at home and abroad, particularly in the case of the US as the issuer of the key reserve currency, and exit is full of pitfalls. Although ultra-easy money is still with us, the markets have begun pricing-in the normalization of monetary policy in the US and this is the main reason for the turbulence in emerging economies. Policy response to an intensification of the stress in the South needs to depart from past practices and should include measures to involve the private creditors in crisis resolution and provision of market support and liquidity by central banks in major advanced economies.

JEL Classification: F34, E50, E66, H12

Keywords: Crisis, Fiscal austerity, Debt workouts, Monetary policy

* Chief Economist, South Centre, Geneva. Former Director and Chief Economist, UNCTAD. Last revision: 24 December 2013. yilmaz.akyuz@bluewin.ch.

CONTENTS

Typesetter: *Rachel Babruskinas*

UNITED NATIONS
Department of Economic and Social Affairs
UN Secretariat, 405 East 42nd Street
New York, N.Y. 10017, USA
e-mail: undesa@un.org
http://www.un.org/en/development/desa/papers/

1 Introduction

Before the world economy could fully recover from the crisis that began more than five years ago, many observers fear that we may be poised for yet another crisis. This is largely because the underlying weaknesses that gave rise to the most serious post-war crisis, namely financial fragilities, income inequalities and global trade imbalances, remain unabated and have indeed been aggravated by the crisis and the misguided policies pursued in response in the US and Europe.

The policy responses to the crisis both in the US and Europe have not been bold enough to match the challenges. First, there has been a reluctance to remove the debt overhang through timely, orderly and comprehensive restructuring, writing down the debt to the extent needed to resolve the crisis. Instead, efforts have focussed on bailing out creditor banks. This has meant protracted deleveraging and spending cuts.

Second, governments have shifted to fiscal austerity after an initial reflation. Even though the net cost of public debt fell significantly as a result of sharp declines in interest rates and increased profit remittances from central banks on their growing holdings of government debt, concerns that public debt may face problems of sustainability once interest rates and central bank balance sheets return to normalcy have shaped the fiscal stance, particularly in view of the unyielding obsession of central banks against money- financing of budget deficits and permanent monetization of government debt. Nor has any consideration been given to providing fiscal stimulus without running deficits by exploiting the so-called balanced-budget multiplier, raising taxes on top income groups to finance additional spending.

All these have resulted in excessive reliance on monetary policy with monetary authorities going into uncharted waters including zero-bound policy interest rates and quantitative easing (QE) through large acquisitions of long-term public and private bonds. These have not been very effective in easing the debt overhang and stimulating spending – hence, the crisis is taking too long to resolve, entailing unnecessary losses of income and jobs and aggravating inequality. But they have also generated destabilizing impulses for the international monetary system and a new round of financial fragility that can compromise growth and stability in the coming years. This is particularly the case for the policies pursued in the US, given its role as the issuer of the key reserve currency.

Developing countries (DCs)[1] have been strongly affected both by the spillovers from the crisis and policy responses in advanced economies (AEs). The crisis has in effect demolished the myth that growth in the South has decoupled from the North and major DCs have become new engines of growth. This is despite the fact that for a large majority of DCs, with the notable exception of those enjoying export-led growth in East Asia, the spillovers from the crisis have not been all that negative. For these countries medium-term prospects look bleak not only because of the failure of the US and Europe to move to robust growth, but also because of the legacy of the policies pursued in the past five years in response to the crisis. It is quite unlikely for DCs to go back to growth rates they enjoyed before the outset of the crisis even though they may see some acceleration over the short-term as the US continues with the ultra-easy monetary policy.

This paper examines the consequences of the crisis in AEs for DCs with a long-term perspective. The following section provides a brief account of the current global economic landscape. This is followed by a critical assessment of policy responses to the crisis in the US and Europe, focussing on their effects on the pace and pattern of recovery as well as their longer-term implications. The next section examines the impact of the crisis on DCs, followed by longer-term prospects. The paper ends with a brief discussion of key policy challenges facing DCs in gaining greater autonomy in growth and development as well as policy options in responding to a possible deterioration of the global economic environment over the coming years.

1 In this paper DCs refer to the UN definition of developing countries whereas emerging economies (EEs) refer to what the IMF calls "emerging market economies".

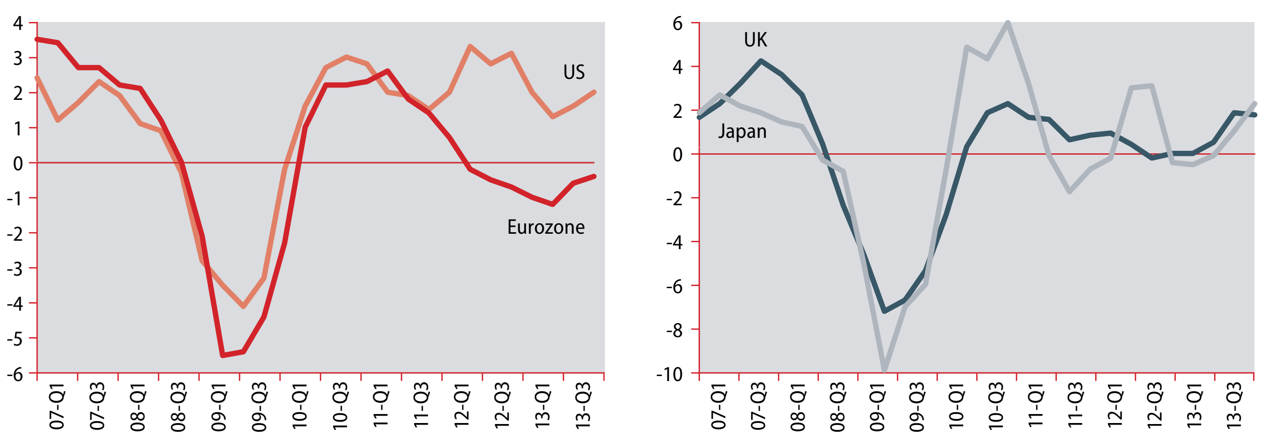
2 The global economic landscape

More than five years since the outbreak of the global financial crisis, the world economy shows little signs of strong and sustained expansion. Growth has started faltering after the bounce-back in 2010 and there is increased agreement that in the coming years it will remain far below the exceptional rates achieved before the onset of the crisis, notably in DCs.

Even though the US economy was at the origin of the crisis, it has fared much better than other major AEs, the Eurozone (EZ), Japan and the UK. First, the 2009 recession was less severe in the US than in the latter economies. Second, the US economy has enjoyed continued, albeit moderate, recovery at an average annual rate of some 2.3 per cent, registering positive growth in every quarter since the end of the recession in mid-2009 (Chart 1). However, this is far below the average rate of 4 per cent seen in the first four years of previous post-war recoveries. Thus, the output gap (that is, the difference between what the economy could and does produce) has diminished only a little. Although the unemployment rate has declined from its peak of 10 per cent in October 2009 to 7 per cent in November 2013, part of the decline is due to the exclusion of discouraged long-term unemployed and the drop in the labour force participation rate (Cohen 2013). At the recent pace, it would take several more years for the US to remove the gap between potential and actual output. On some estimates, the economy would return to pre-crisis (2007) employment levels only in August 2018 if it creates as many jobs as it did in the best year of job creation in the 2000s (Hamilton Project 2013). This is no better than the Great Depression when it took 10 years for employment to fully recover.

Most other major AEs have contracted again after 2009. Following a severe recession in 2009 the EZ as a whole achieved positive growth in the subsequent two years despite continued output and employment losses in the periphery, thanks to a strong recovery in Germany driven by exports. However, as the impact of the crisis spread in the region, the core and Germany in particular could not maintain the momentum. The region had 6 consecutive quarters of negative growth until the second quarter of 2013 with about half of the countries in recession. Both the IMF and the OECD project negative growth for 2013 for the region as a whole. Average unemployment has exceeded 12 per cent– it is over 25 per cent in Spain and Greece, higher than the levels seen during the Great Depression. As of end-2013 the region is in outright deflation with producer prices, money supply and private credit all falling.

Chart 1
GDP Growth in Major AEs (per cent change)



Source: Trading Economics (http://tradingeconomics.com).
Note: Quarterly data.

Although financial stress in the EZ has eased considerably, continued contraction and adjustment fatigue in the periphery could bring it back and even lead to a break-up. However, it is difficult not only to predict the evolution of the EZ in the near future, but also the impact of a break-up, since past economic and financial linkages would provide little guidance for estimating the consequences of such an unprecedented event. Still, even without a total break-up, an intensification of financial stress could have serious repercussions for DCs, as suggested by various downside scenarios simulated by the IMF (2012), the UN WESP (2013) and the OECD (2012).

Of the other major AEs, Japan could not sustain positive growth after recovering from the 2009 recession and went into a second dip in 2011. In the last quarter of 2012 it experienced its 7th quarterly contraction since the collapse of Lehman Brothers. After making a rebound thanks to Abenomics, growth has slowed in mid-2013 and may lose steam further because of planned fiscal tightening. Again, from 2009 until the end of 2012, the UK had negative growth rates in 9 out of 20 quarters and has lost 3.7 million jobs. 2013 growth is expected to be less than 1.5 per cent, but still the best among the EU's big 5. In both countries output remains below its pre-crisis peak.

DCs enjoyed exceptional growth before the onset of the crisis thanks to highly favourable but unsustainable global conditions, rather than improvements in their own growth fundamentals (Akyüz 2012a). In the early months of the crisis they were expected to decouple from the difficulties facing AEs. The decoupling myth came back with full force when DCs recovered rapidly after a short-lived downturn in 2009, while recovery in the US remained weak and Europe went into a second dip.

The IMF has been a major advocate of the decoupling thesis. Its analysis and projections show significant shortcomings in its understanding of growth fundamentals in the South and their global linkages. It underestimated not only the depth of the financial crisis, but also its impact on DCs, maintaining that the dependence of growth in the South on the North had significantly weakened (IMF WEO April 2007 and April 2008). After 2010 it has constantly over-projected growth in DCs. Eventually it has had to recognize the possibility that "recent forecast disappointments are symptomatic of deeper, structural problems", revising downward the medium-term prospects of these economies (IMF WEO April 2013; 19). In a more recent report submitted to the St. Petersburg meeting of the G20, the Fund "has dropped its view that EEs were the dynamic engine of the world economy" in a "humbling series of U-turns over its global economic assessment" (Giles 2013). Its latest assessment is that the "world's economies moved much more in lockstep during the peak of the global financial crisis than at any other time in recent decades…. The increased comovement … was observed across all geographic regions and among advanced, emerging market, and developing economies." (IMF WEO October 2013: 81).

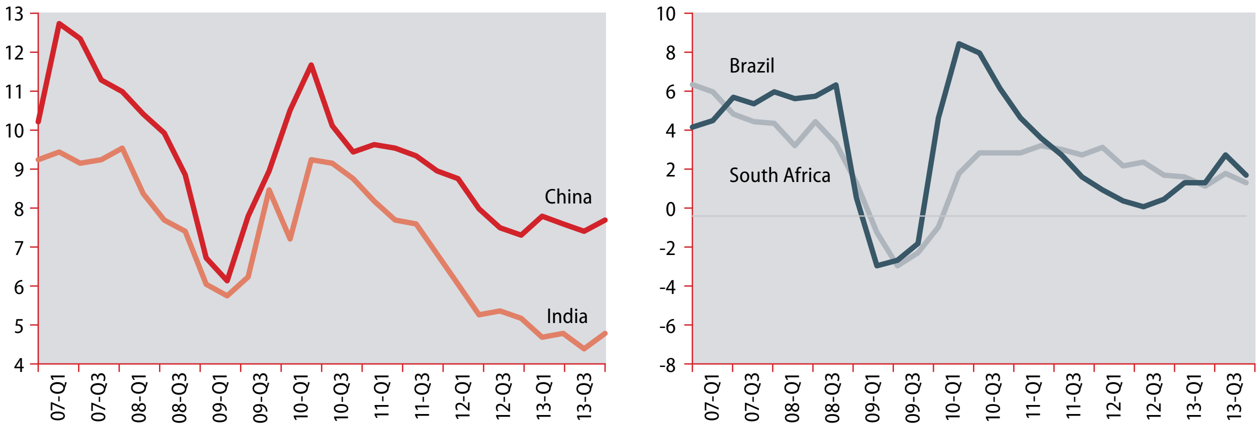
Indeed, as strong upward trends in capital flows and commodity prices ended, recovery in AEs has remained weak, the one-off effects of countercyclical policies in DCs have started fading and the policy space for further expansionary action has narrowed, growth in the South, including China and other major DCs, has decelerated considerably (Chart 2). In Asia, the most dynamic developing region, in 2012 it was some 5 percentage points below the rate achieved before the onset of the crisis; in Latin America it was almost half of the pre-crisis rate. In none of these regions the outlook for 2013-14 promises a significant improvement.

3 Policy response in the US and the EZ: Neo-liberal fallacies and obsessions

Why is the crisis taking too long to resolve?

In his remarks on the state of the world economy, the IMF's chief economist, Olivier Blanchard is reported to have said; "It's not yet a lost decade… But it will surely take at least a decade from the beginning of the crisis for the world economy to get back to decent shape" (Reuters 2012). Presumably, this remark must

Chart 2
GDP Growth in Major DCs



Source: Trading Economics (http://tradingeconomics.com).
Note: Quarterly data.

reflect a judgment not only about the nature and depth of the crisis, but also about the effectiveness of public interventions to resolve it.

There can be little doubt that recoveries from recessions brought about by financial crises are weak and protracted because it takes time to repair balance sheets – to remove debt overhang and unwind excessive and unviable investments generated during the bubbles that culminate in such crises. Recoveries from such crises also tend to be jobless and yield little investment. This was the case in the US during the early 1990s and particularly the early 2000s when it was recovering from recessions brought about by the bursting of the savings and loans and dot-com bubbles, respectively. In the current recovery, the pre-crisis income in the US had been restored by the second quarter of 2011, but employment was lower by some 6.5 million. Sluggish job and investment growth is also a common feature of recoveries of DCs from financial crises (Akyüz 2006).

However, the pace of recovery also depends on the management of the crisis. In this respect, there are two major shortcomings in the policy response both in the US and Europe. First, governments have been unwilling to remove the debt overhang through timely, orderly and comprehensive restructuring and to bring about a redistribution of wealth from creditors to debtors. Instead, they have resorted to extensive creditor bailouts, increasing the moral hazard and vulnerabilities in the financial system. Second, there have been serious shortcomings in macroeconomic policy measures in support of aggregate demand, growth and employment. After an initial reflation governments have turned to fiscal orthodoxy and relied excessively on monetary means to fight recession. These have not only led to unnecessary output and job losses, but have also caused financial fragilities that could compromise future stability and growth.

The debt overhang

A key intervention in the crisis in the US was the Troubled Asset Relief Programme of 2008-09 whereby $700 billion was injected into banks whose net worth was moving into red as a result of loss of asset values as well as some large corporations in the auto industry to prevent bankruptcy. Furthermore, after cutting its policy rate sharply, the Fed launched a policy of QE, buying US government bonds and mortgage-backed securities to boost their prices. In December 2012 the Fed provided forward guidance by announcing that it would keep the funds rate near zero and continue buying $85 billion worth of bonds and securities until unemployment fell below 6.5 per cent or inflation rose above 2.5 per cent under what has come to be known as QE3.

A main objective of QE is to reduce the cost of debt by lowering long-term rates. The government also introduced two voluntary schemes to encourage lenders to lower mortgage payments of homeowners facing the risk of foreclosure and help homeowners with negative equity to refinance their mortgages. However, so far it has not chosen to bring down household mortgages in line with their ability to pay by forcing the creditors to write down debt.[2]

These interventions have prevented a banking collapse and hence ended the financial crisis but not the economic crisis. They have allowed the banks first to recover their pre-crisis profitability in 2012 and then reach record profits in 2013. The four biggest US banks are now 30 percent larger than they were before the crisis and the too-big-to-fail banks are bigger (Warren 2013). However, they have done little to reduce the debt overhang, prevent foreclosures or increase lending. Although household debt has dropped by some 10 per cent of GDP since the beginning of the crisis, much of this has been due to foreclosures and hence reflects a corresponding reduction in household wealth. Homes of many households continue to be worth less than the principal balances on their mortgages. As noted by Bernanke (2013), "gains in household net worth have been concentrated among wealthier households, while many households in the middle or lower parts of the distribution have experienced declines in wealth since the crisis." The income gap between the rich and the poor has also widened. From 2009 to 2011, the top 1 per cent incomes grew by 11.2 per cent while the bottom 99 per cent incomes shrunk by 0.4 per cent (Saez 2012). The households in the middle now have lower real incomes than they did in 1996 and this is slowing the recovery by holding back aggregate spending (Stiglitz 2013).

In the EZ the policy response has been premised on a wrong diagnosis, thereby deepening the recession. The periphery is, in effect, facing a balance-of-payments-*cum*- external-debt crisis resulting from excessive spending and foreign borrowing of the kind seen in several DCs in the past decades. Contrary to the official diagnosis, this had little to do with fiscal profligacy except in Greece (Lapavitsas *et al.* 2010; De Grauwe 2010). It is total external debt, both public and private, rather than total public debt that is the key to understanding the EZ crisis. For instance Belgium had a higher public debt ratio than most countries in the periphery but did not face any pressure because it has had a sustained current account surplus and a positive net external asset position (Gros 2011).

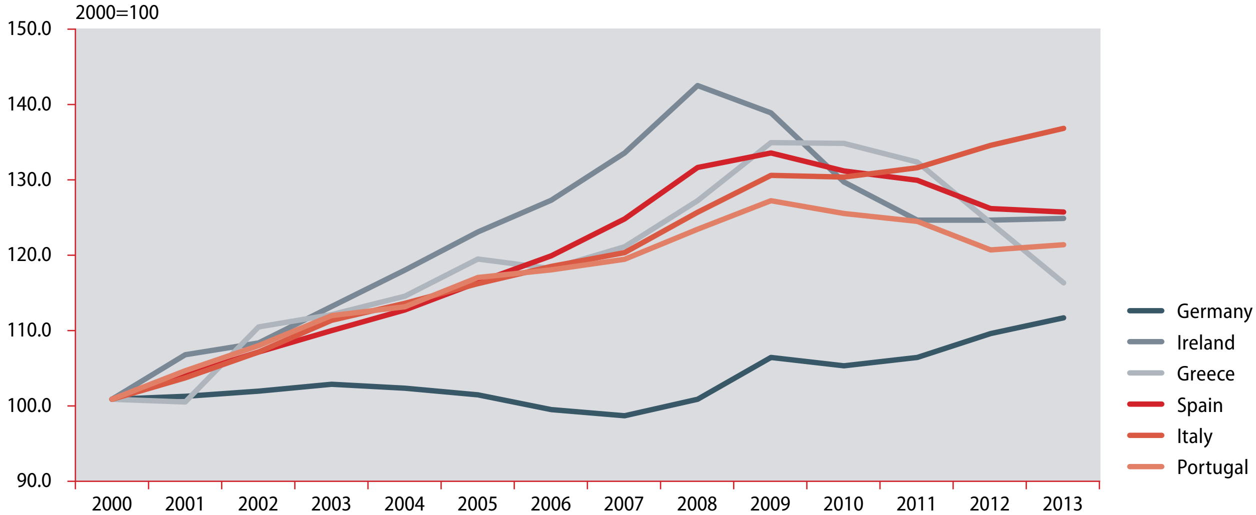
The crisis-hit periphery countries all had larger current account deficits than other EZ members in the run-up to the crisis. In Spain and Ireland, deficits were entirely due to a private savings gap. Two interrelated factors played an important role in rapid increases in external deficits and debt in the periphery. First, after the monetary union, wage and price movements diverged sharply between the periphery and the core (Chart 3). From early 2000 Germany was engaged in a process of "competitive disinflation", keeping real wages virtually stagnant, reducing unit labour costs and relying on exports for growth (Akyüz 2011a, Palley 2013). By contrast, in the periphery wages went ahead of productivity, leading to an appreciation of the real effective exchange rate. This created a surge in imports, mainly from other EU countries.

This was greatly helped by a surge in capital flows from the core to the periphery, including loans from German banks, triggered by the common currency and abundant international liquidity (Sinn 2011). They fuelled the boom in domestic demand, reduced private savings and widened the current account deficits in the periphery (Atoyan *et al.* 2013). As in Latin America in the early 1980s, this process also ended with a shock from the US, this time the subprime crisis, leading to a sharp cutback in lending.

2 The Federal Housing Finance Agency which regulates government-controlled mortgage financiers Fannie Mae and Freddie Mac has constantly opposed principal reduction. In mid-2012 a bipartisan bill was introduced to allow the so-called underwater home owners whose home values fall short of their debt to reduce their monthly payments in exchange for a portion of any future price appreciation on the home (known as shared appreciation), effectively implying a debt for equity swap; see, Griffith (2012). At the time of writing this paper this legislation had not yet taken effect.

Chart 3

Unit labour costs in the Euro zone



Source: Eurostat.

The strategy adopted by EZ policy makers in dealing with the debt problem was very much like that of the failed Baker Plan pursued in response to the Latin American debt crisis in the 1980s – lending to keep debtors current on their payments to creditors and austerity (UNCTAD TDR 1988: chap. 4). For this purpose several facilities have been introduced and used together with IMF lending. The ECB has also engaged in purchasing sovereign bonds in order to lower borrowing costs to troubled debtors, and provided long-term loans to banks at low interest rates to enable them to buy high-yield sovereign bonds and earn large spreads.

Despite occasional references to the need to involve the creditors in the resolution of the crisis, interventions have mainly served to bail out creditor banks. As pointed out by the chairman of the European Banking Authority, Andrea Enria, too few European banks have been wound down and too many of them have survived (Reuters 2013a). Public money has been used to bail out banks, leading to increased sovereign debt. By contrast, the debt-restructuring initiatives have brought limited relief to debtors. Greek workouts in 2012 failed to remove the debt overhang. Greece now needs a deep write-off, but around 70 per cent of its sovereign debt is held by the official sector, including the ECB, IMF, national central banks and other EZ governments, and the write-down of this debt is resisted by the ECB and Germany. There have also been inconsistencies in the approach to bailing in creditors. In Ireland and Spain where the crisis originated in the banking system, creditors and depositors of troubled banks have largely escaped without haircut. Ireland gave a blanket guarantee to its bank depositors and Greek workouts also spared deposit holders both at home and abroad. In most of these cases rescue operations involved large amounts of public money to prop up and recapitalize banks. By contrast, in Cyprus the bailout package inflicted large losses on deposit holders, notably Russians.[3]

Public debt ratios have been rising in the periphery because of recession, relatively high interest rates and the failure to bail in creditors (Chart 4). A fundamental dilemma is that when the debt ratio is high and the real interest rate exceeds the growth rate by a large margin, the primary surplus needed to stabilize the debt ratio would be quite high, but cuts made in

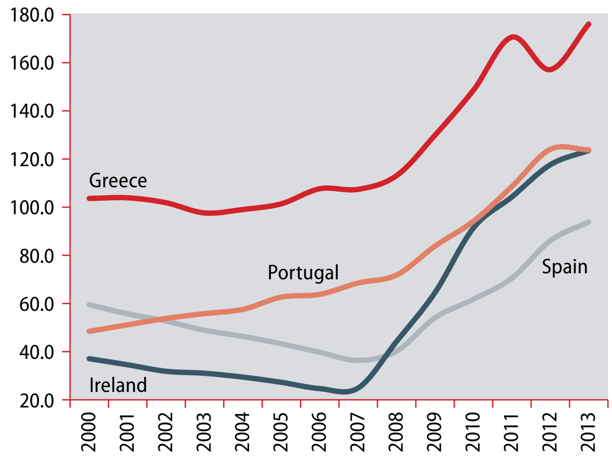
3 Ironically, while the operation in Cyprus was meant to penalize “Russian money launderers”, the forced conversion of deposits into shares has led the Russians to take control of Bank of Cyprus – Higgins (2013).

primary spending to achieve this would create a sizeable contraction in output, making the task even more difficult. Thus, debt ratios of Spain and Ireland have reached 100 per cent and 120 per cent, respectively, from around 40 per cent on the eve of the crisis. For the same reason, the intensification of fiscal consolidation has not always resulted in lower budget deficits.

Not have all countries hit by the bursting of the speculative bubble failed to remove the debt overhang. In this respect, Iceland's debt resolution initiatives stand in sharp contrast to the approach pursued in the US and the EU. Relative to the size of its economy, Iceland faced the biggest banking failure in economic history. However, it has managed to restructure the banking system by letting some of the banks fail and bailing in private creditors, sparing both taxpayers and domestic depositors from paying the price. It has imposed capital controls to stem exit and passed an important part of the burden onto international creditors including bondholders and depositors – an option that is not really open to the EZ periphery, at least in so far as their intra-EZ debt is concerned.[4] More importantly, from the end of 2008 until 2013 Iceland's banks wrote off debt for more than a quarter of the population, by some 13 per cent of 2012 GDP. An important part of this is on mortgage debt exceeding 110 per cent of home values. This has played an important role in the recovery of Iceland from a deep recession. It has achieved some 2 per cent growth per annum since 2011, with an unemployment rate of around 5 per cent, against continued recession and double-digit unemployment in the EZ periphery. In November 2013 the government announced, against the advice of the IMF and rating agencies, a further debt relief package for mortgage holders to assist over 100.000 households, to be financed through tax hikes on financial institutions and a haircut on debt owed to overseas investors by Iceland's failed banks, now largely held by hedge funds which acquired them at deep discounts (Reuters 2013b).

Chart 4

Public debt as per cent of GDP



Source: IMF Fiscal Monitor Database (October 2013).

Fiscal orthodoxy

The failure to intervene directly to remove the debt overhang in a timely and orderly manner has meant protracted deleveraging and spending cuts. As a result, monetary policy has become largely ineffective in expanding credit and stimulating private spending. Fiscal policy has gained added importance, but both the US and Europe have shifted to austerity after an initial reflation. In the EZ, the core has also joined in the austerity imposed on the crisis-hit periphery.

The case for fiscal austerity is premised on two propositions. First, budget deficits add more to public debt than to GDP so that they would raise the debt-to-GDP ratio. Second, high ratios of public debt to GDP are detrimental to growth. It is thus believed that fiscal austerity would not undermine growth and could even stimulate it by lowering the ratio of public debt to GDP hence the so-called "expansionary austerity".

The first proposition implies that fiscal multipliers are small. This comes from highly controversial theories that higher public spending would crowd out private spending by pushing up the interest rate and that private sector would start spending less and saving more

4 However, the resolution of the failed banks has not been completed and a number of contentious issues still remain, particularly with respect to claims by creditors and depositors in the UK and Holland, posing th reats to Iceland's financial stability – see, Bowers (2013) and Baldursson and Portes (2013).

in order to provide for future tax increases needed to meet increased government debt servicing. Most economists would agree that these theories make no sense under conditions of liquidity trap and falling incomes, respectively. Still, in the early years of the crisis, the fiscal policy advice of the IMF was premised on extremely low multipliers and was invariably pro-cyclical. Because of the underestimation of fiscal multipliers, IMF growth projections turned to be more optimistic than growth outcomes in several periphery countries with IMF programmes (Weisbrot and Jorgensen 2013). However, as a result of mounting evidence on fiscal drag, the IMF has finally admitted that fiscal multipliers are much greater than was previously believed and that they are state-dependent, particularly large under recessions, with the implication that fiscal austerity could in fact raise the debt ratio by depressing income (IMF WEO October 2012; Blanchard and Leigh 2013).

The second proposition that high debt ratios could deter growth found support in the finding of an empirical study by Reinhart and Rogoff (2010) that economic growth slows sharply when the ratio of government debt to GDP exceeds 90 per cent. However, it is generally agreed that such an association says effectively nothing about causality – slow growth could cause high debt rather than high debt leading to slow growth. More importantly, subsequent research by Herndon *et al.* (2013) has found that several critical findings advanced in the Reinhart and Rogoff (2010) study are wrong and in fact a 90 per cent debt ratio is associated with a much higher rate of growth than was found by these authors.

In any case expansionary fiscal policy does not necessarily entail greater public deficits and debt. The combination of progressive taxation with increased public spending could give a significant boost to economic activity without creating deficits and debt or significantly crowding out private spending. Under conditions of deflation when private spending remains depressed, the so-called balanced-budget multiplier tends to be quite high particularly if public spending is financed by additional taxes on top income groups. This is particularly true for the US and UK where income and wealth inequality is much greater than other major OECD countries and taxation is much less progressive.[5] However, the ideology behind the crisis intervention has excluded such socially progressive and economically beneficial solutions.

In the US the immediate fiscal stimulus introduced in response to the subprime crisis no doubt played an important role in initiating recovery (Blinder and Zandi 2007). However, as soon as the economy started to show signs of life, fiscal orthodoxy has returned and "discretionary fiscal policy hasn't been much of a tailwind" (Yellen 2013a: 4). Cuts in public sector jobs and other government spending reduced growth by 0.6-0.8 percentage points during 2011-12. Fiscal retrenchment has continued into 2013 and is estimated to place a significant drag on GDP growth (Conference Board 2013).

In the EZ lending to debtor countries incorporated austerity in the form of tax hikes, spending and wage cuts, leading to a deepening of contraction. In a subsequent evaluation of the 2010 Stand-By agreement for Greece, the IMF (2013c) has admitted that it had underestimated the damage done to the economy from spending cuts and tax hikes imposed in the bailout and that it deviated from its own debt-sustainability standards and should have pushed harder and sooner for lenders to take a haircut to reduce Greece's debt burden.

Ultra-easy monetary policy

The reluctance to use fiscal policy to expand aggregate demand has resulted in excessive reliance on monetary policy, particularly as fiscal austerity has become self- defeating by lowering growth. However, rapid expansion of liquidity and historically low interest rates has not been very effective in stimulating lending to the non-financial sector and private spending. Much of the money injected into the economy through massive QE programmes, notably in the US

5 See Piketty et al. (2011) who argue that the top tax rate on the top 1 per cent income earners could be raised to over 80 per cent without impairing growth and that the potential tax revenue at stake is very large.

and UK, has ended up back in central banks in the reserves accounts of the banking system as excess reserves. Because of increased risk aversion, banks have been unwilling to lend to households and small businesses while big businesses have little need for loans or appetite for new spending on labour and equipment in view of sluggish demand.[6] Nor is there any sign of a strong wealth effect on spending from rising asset prices because the gains are reaped mainly by the very rich.

Still, by lowering long-term interest rates and rapidly increasing the central bank holding of long-term government debt, the ultra-easy monetary policy has served to widen fiscal policy space. On the one hand, it has resulted in a significant decline in interest payments on government debt. On the other hand, much of the interest payments on debt held by central banks have gone back to the budget as profit remittances. It is estimated that by the end of 2012, total benefits of governments in the US, UK and the EZ taken together from both reduced debt service costs and increased profits remitted from central banks reached $1.6 trillion (Dobbs *et al*. 2013). This space has not been used effectively and fiscal orthodoxy has prevailed. In the US alone, for 2007-12 total benefits were above $1 trillion, exceeding the total fiscal stimulus of some $800 billion provided throughout this period (Amadeo 2013). In other words, beyond the space provided by the ultra-easy monetary policy, discretionary fiscal stance in the US has been contractionary.

Not only has monetary policy failed to fuel a strong recovery by lifting private spending, but it has also given rise to an important build-up of financial fragility by triggering a search-for-yield in "the riskier part of the credit spectrum" including high-yield bonds, subordinated debt and leveraged syndicated loans, "a phenomenon reminiscent of the exuberance prior to the global financial crisis." (BIS 2013: 1, 7). There has also been a growing willingness to take leveraged positions in long-term assets with short-term finance, both in the US and globally. These have created a strong recovery if not a bubble in equity prices with the benchmark US equity index the Dow Jones Industrial Average (Dow) reaching historical highs.[7]

These developments have caused concern at the Fed with Bernanke (2013) warning that asset prices may be delinked from fundamentals, generating mispricing (see also IMF 2013a and Yellen 2013b). There is considerable uncertainty regarding the implications of an extended period of ultra-easy money for financial stability, since these are largely uncharted waters (White 2012). As discussed in Section E below, if it persists much longer, credit and asset bubbles could start to form and reach dangerous levels, leading to yet another boombust cycle (Roubini 2013). As the incoming Fed chairman Janet Yellen has argued, even though there is yet no bubble in equity or property markets, the longer the QE continues, the greater the risk for financial stability (Fontevecchia 2013). However, it may be also difficult to exit without disrupting markets and impairing growth (Stein 2013). Although the Fed and the IMF appear to be taking note of the longer-term risks to stability and growth, they may not be able to identify them correctly or act in a timely and effective manner better than they did during the subprime build-up.

Since the large quantities of liquidity provided to the banking system through QE has failed to expand credits and private spending, a way out could have been to make the money available directly to those who are willing to spend but cannot do so because of tight budget constraints and debt overhang. Milton Friedman has long suggested dropping money from helicopters to avert deflation. In a speech given in 2002 before becoming the chairman of the US Fed,

6 An additional impediment to lending is sharp increases in bank capital ratios. While this may be useful in preventing the next crisis, it is a procyclical measure in so far as the ongoing crisis is concerned.

7 These imply that monetary conditions are too tight for the real economy but too loose for financial markets. To put in conventional terms, because of the zero lower bound, monetary policy could not bring down the interest rate to a level needed to create sufficient demand to close the deflationary gap – if, of course, such a level exists. It could not raise inflation in markets for goods and services, but is capable of doing so in markets for assets. Thus, avoiding bubbles and securing growth would depend very much on fiscal policy.

Bernanke referred to helicopter money as a way of reversing deflation, noting that "the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost" and that "a determined government can always generate higher spending and hence positive inflation." He then went on to argue that "the effectiveness of anti-deflation policy could be significantly enhanced by cooperation between the monetary and fiscal authorities" and that "money-financed tax cut is essentially equivalent to Milton Friedman's famous 'helicopter drop' of money." He also added that instead of tax cuts the government could also go for money-financed spending on current goods and services (Bernanke 2002: 4, 6).

However, QE is an exchange of assets, newly printed dollars for bonds including toxic assets in the balance sheets of the banks, not a helicopter drop of money which bypasses the banking system. The Fed's purchases of long-term Treasuries do not provide the government non-debt creating, interest-free resources unless such debt is monetized indefinitely. As long as the bonds acquired by the Fed stay on its balance sheet, they do not entail net cost to the government because of profit remittances noted above. But as soon as the expansion of the Fed's balance sheet is reversed and these bonds exit the Fed's balance sheet (that is, they mature without being replaced or they are liquidated), these profits would dry up. This, together with the return of interest rates to normalcy, would increase debt servicing cost significantly. Thus, permanent monetization of government debt provides a viable answer to deflation and long-term debt sustainability.[8] The case for overt monetary financing also applies to deficits resulting from bailout operations to recapitalize insolvent banks. It allows stabilizing the banking system without adding to government debt and hence shifting solvency concerns from banks to sovereigns, as has happened in some EZ periphery countries (Turner 2013b).

Under deflationary conditions "money-financed" spending or tax cuts need be no riskier for financial stability than the ultra-easy monetary policy, since the money thus created would not find its way directly into asset markets. As the former chairman of the UK Financial Services Authority has argued, the attempt to escape from the deleveraging trap by excessive monetary accommodation could lead to severe future vulnerabilities and the idea that overt money finance of fiscal deficits is inherently any more inflationary than the other policy levers used to stimulate demand is without any technical foundation.[9] He concludes that the main challenge is how to "design institutional constraints and rules that would guard against the misuse of this powerful medicine." (Turner, 2013a: 24; see also White 2013; Turner 2013b; Wolf 2013a). However, none of the governments in the AEs in crisis have been willing to break the taboo and abandon the obsession against direct financing of budget deficits and permanent monetization of government debt even though some central banks, including the Bank of England are reported to have given considerations to such a solution.[10]

Many studies have found that without ultra-easy monetary policy, recession would have been deeper and unemployment higher in the AEs hit by the crisis.[11] This is beyond doubt. However, these

8 This could be done in two ways. The government can issue debt directly to the central bank to finance its additional spending or the central bank acquires the additional debt through QE operations. In both cases the central bank makes a commitment that it would not reverse the expansion of its balance sheet resulting from the additional acquisition of government bonds.

9 If a permanent increase in money supply resulting from deficit financing turns out to be inflationary, it can be reduced by using bank reserve requirements rather than selling government bonds – see Turner (2013).

10 See Financial Times (2012). In 2011 Bernanke ruled out direct lending to state and local governments, saying that the Fed had limited legal authority to help and little will to use that authority; Wall Street Journal (2011).

11 See e.g., IMF (2013d). For a review and the impact of unconventional monetary policies on distribution and stability see, Dobbs et al. (2013). A study at the San Francisco Fed found that QE2 added just 0.13 percentage points to growth in 2010 and that interest rate forward guidance has greater effect than asset purchases; see Curdia and Ferrero (2012).

studies do not explore what would have happened to employment and output under a counterfactual scenario including timely, orderly and comprehensive debt restructuring, permanent monetization of government deficits and debt, or additional public spending financed by progressive taxation, or the kind of future vulnerabilities that would have been entailed by such an alternative policy mix in comparison with the ultra- easy monetary policy.

4 Spillovers to developing countries

The failure to achieve a rapid recovery and remove income and employment gaps in AEs has meant strong and sustained trade shocks to DCs, notably the major exporters of manufactures as well as smaller countries heavily dependent on markets in the US and Europe. However, until recently growth in DCs has shown considerable resilience after an initial downturn in 2009. Three factors have played a major role.

First, DCs were able to give an unprecedented, swift and strong countercyclical policy response through monetary and fiscal measures, turning increasingly to domestic demand for growth. This was made possible by favourable payments, reserves and fiscal positions built-up during the preceding expansion (Akyüz 2012a). There was no recourse to interest rate hikes in defence of currencies which had come under pressure with rapid exit of capital after the Lehman collapse. In fact, as capital flows stabilized, interest rates were lowered in an attempt to stimulate domestic demand. The countercyclical fiscal response was unprecedented, especially in East Asia, and the spending packages introduced were far greater, as percentage of GDP, than those in AEs, including the US where the crisis originated.

Second, China's policy response to the crisis through massive investment in infrastructure and property to offset the decline of its exports to AEs provided a major boost to commodity exporters. Third, despite occasional protests against the pressures put on their currencies by rapid expansion of liquidity in major AEs, the impact of the ultra-easy monetary policy on DCs has generally been benign. Together with a favourable shift in risk perceptions in favour of DCs, it has played a major role in the quick recovery of private capital flows after the sudden reversal triggered by the Lehman collapse, thereby allowing many deficit DCs to expand domestic demand without facing a payments constraint.

However, these could not be sustained. Outside China and a few other countries, fiscal and payments constraints have generally started biting in most DCs as they shifted to domestic-demand-led growth, leading to fiscal tightening.[12] Second, China could not keep on filling the demand gap with investment in view of several problems created by its earlier stimulus package, including excess capacity and over-indebtedness. Third, capital inflows have weakened and become highly unstable, first with the deepening of the EZ crisis and then with the prospects of the Fed tapering bond purchases. Consequently, DCs have started to face greater difficulties in maintaining strong growth at later stages of the crisis than at the beginning, losing momentum from 2011 onwards with growth falling well below the rates seen before the onset of the crisis and in the aftermath of the Lehman collapse.

Trade shocks and imbalances

Trade has been the single most important channel of transmission of contractionary impulses from the financial crisis and recession in the US and Europe to DCs. While all DCs have been hit directly or indirectly, the incidence varied from country to country according to their dependence on exports, the relative importance of markets in AEs and the import content of their exports.[13] Cuts in exports of DCs to the US and Europe have also resulted in a

12 According to Ortiz and Cummins (2013) many DCs joined fiscal austerity after 2010 and premature expenditure cuts became widespread.

13 On variations of dependence on exports of DCs, see UNCTAD (2009).

significant compression of imports used both for exports and domestic consumption and investment. As a result of these cumulative effects, the world trade volume declined at much the same rate as the rate of decline of volume of imports by AEs.

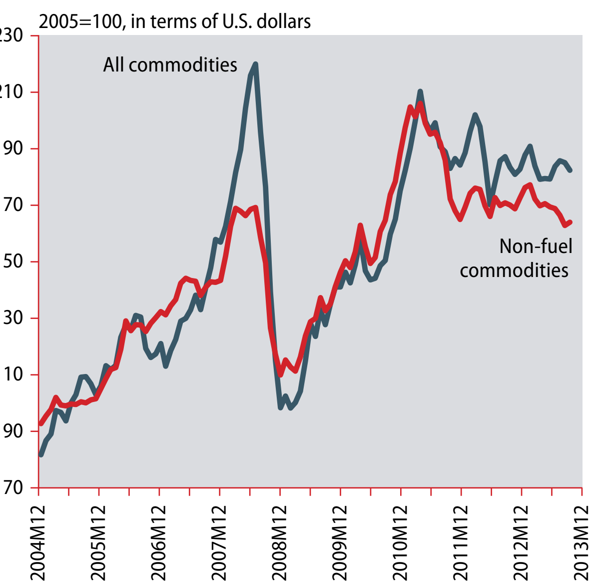
Trade shocks have been particularly severe for China because of its dependence on exports to AEs. In the period 2002-07, Chinese exports grew by more than 25 per cent per annum, accounting for about one-third of GDP growth, taking into account their import content. The dependence on exports to AEs was even higher for smaller exporters of manufactures in Asia, both directly and through supplying parts and components to China. With the crisis in AEs, exports of Asian DCs first slowed sharply in 2008 and then dropped in 2009, and became a major drag on activity, reducing growth by 5-6 percentage points (Akyüz 2012a). Import cuts in Europe have also hit Africa especially hard because of strong trade linkages (IMF 2011; OECD 2012; Massa *et al.* 2012).

Countercyclical policy response in major commodity-importing countries, notably China and to a lesser extent India played a major role in the rapid recovery of commodity prices after a sharp decline in 2008 (Chart 5). China's shift from export-led to investment- led growth created a massive increase in its commodity imports since investment in property and infrastructure is much more intensive in commodities, notably in metals, than exports of manufactures which rely heavily on imported parts and components. China's primary commodity imports doubled between 2009 and 2011 compared to some 50 per cent increase in its manufactured imports. During the same period prices of metals rose by 2.4 fold, much faster than other primary commodities. As growth fell in China and India after 2011, commodity prices have levelled off and showed sharp declines in some categories, notably metals.

All these have resulted in significant changes in the pattern of world trade. Before the crisis South-South trade was largely conditioned by trade between DCs and AEs. China's imports from DCs accounted for a large proportion of South-South trade and an important proportion of these were used, directly or indirectly, for its exports of manufactures to AEs (Akyüz 2012a). With the shift of China to investment-led growth, not only has there been a shift in Chinese imports from manufactures to commodities, but also a larger proportion of its imports have come to be used for domestic demand. This has also meant that for many commodity-dependent DCs, China has become the single most important market. For instance, in 2007 Brazilian exports to the EU and US were four times and twice the level of its exports to China, respectively. Now Brazilian exports to China and Europe are about the same and Brazilian exports to the US are one-half of its exports to China.[14]

Chart 5

Primary commodity prices: December 2004-October 2013



Source: IMF, Primary Commodity Prices database

The crisis has also resulted in a redistribution of trade imbalances at the expense of DCs with their increased reliance on domestic demand for growth. On the eve of the crisis, DCs taken together had a

14 Brazilian export earnings from commodities now exceed those from manufactures by a large margin; see Canuto et al. (2013). Commodities have also come to account for an increasing proportion of exports of several semi-industrialized DCs such as Malaysia, if measured in value-added terms.

current account surplus of more than $700 billion and about half of this was due to China. This fell to $260 billion in 2013. The surplus of developing Asia fell from $430 billion to $140 billion while Latin America and sub-Saharan Africa both moved from small surpluses to sizeable deficits. AEs taken together had a current account deficit of $480 billion in 2008. This fell constantly after the onset of the crisis and is expected to move to a surplus at the end of 2013. The US deficits fell by more than $200 billion while the EZ moved from a deficit of $100 billion to a projected surplus of $300 billion in 2013.

In the run-up to the crisis the share of private consumption in GDP was on a downward trend and GDP was growing faster than domestic demand in all three major surplus economies, Germany, Japan and China. Growth was much slower in Germany and Japan but more dependent on exports than in China where imports too expanded at double-digit rates thanks to a very strong growth of domestic demand (Akyüz 2011a). After the onset of the crisis, the German surplus has increased rapidly, reaching $230 billion or 7 per cent of GDP at the end of 2012; it is expected to show only a moderate decline in 2013 (Table 1). By contrast, both Japan and China have seen sharp declines in their current account surpluses; the decline in China's surplus is particularly dramatic, from a peak of 10 per cent of GDP in 2007 to 2.5 per cent. While Germany has increased its reliance on exports, sucking in foreign demand and effectively exporting unemployment, China has provided a major stimulus to the rest of the world by maintaining a strong domestic demand and allowing its real effective exchange rate to appreciate by some 20 per cent since the onset of the crisis.

Table 1

GDP, Domestic Demand and Current Account in Main Surplus Countries

(Annual per cent change unless otherwise indicated)	2004-07	2010	2011	2012	2013e
Germany					
GDP growth	2.2	3.9	3.4	0.9	0.5
Domestic demand	1.1	2.4	2.8	-0.3	0.5
Private consumption	0.5	1.0	2.3	0.8	0.8
CA (% of GDP)	5.9	6.3	6.2	7.0	6.0
Japan					
GDP	1.9	4.7	-0.6	2.0	2.0
Domestic demand	1.1	2.9	0.3	2.8	1.7
Private consumption	1.2	2.8	0.4	2.3	2.0
CA (% of GDP)	4.0	3.7	2.0	1.0	1.2
China					
GDP	12.1	10.4	9.3	7.8	7.8
Domestic demand	10.3*	10.6	10.2	8.4	8.3
Consumption (total)	8.8*	9.2	11.0	8.4	8.5
CA (% of GDP)	7.1	4.0	1.9	2.3	2.5

Source: For Germany and Japan IMF WEO (October 2013 and October 2012). For China, IMF Staff Report: Article IV Consultation with the People's Republic of China (various years).

* 2005-2007 average. e: Projection.

Financial spillovers and vulnerability of emerging economies

Although the boom in private capital inflows to EEs that had begun in the early years of the 2000s came to an end with the flight to safety triggered by the Lehman collapse in September 2008, the recovery was quick, helped by monetary policies in the US and Europe and shifts in risk perceptions against AEs (Chart 6). Throughout 2010-12 capital inflows in absolute nominal terms were only slightly below the peak reached in 2007, but were lower as a per cent of GDP of recipient countries – around 4 per cent compared to over 8 per cent in 2007. This relative weakness of private capital inflows reflected, in large part, sharp drops in inflows to European EEs due to strong fallouts from the EZ crisis. By contrast, net inflows to Asia and Latin America exceeded the peaks reached before the crisis (Chart 7).

Chart 6
Private capital inflows to emerging economies, 1995-2014

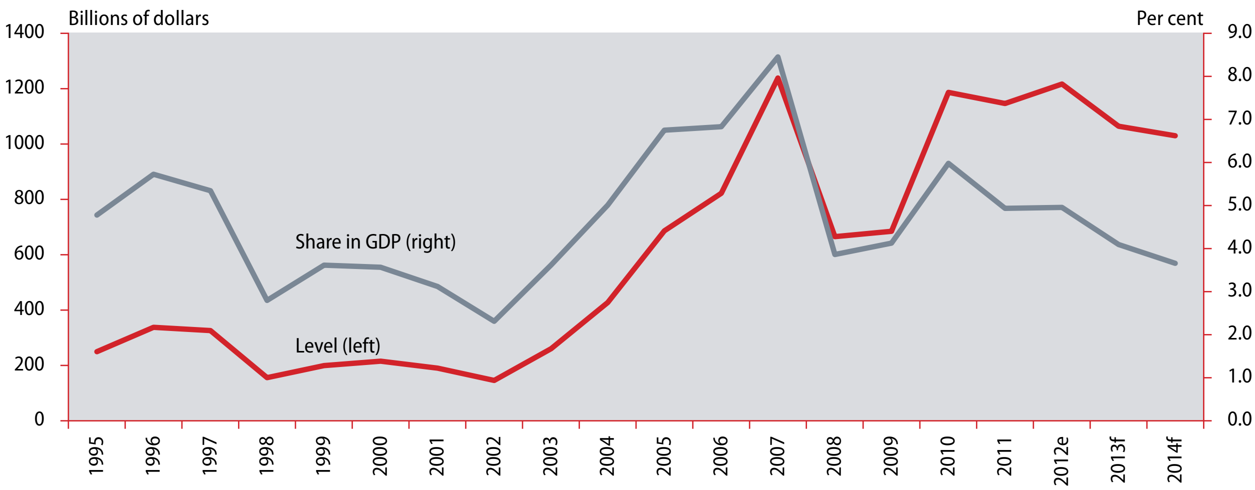
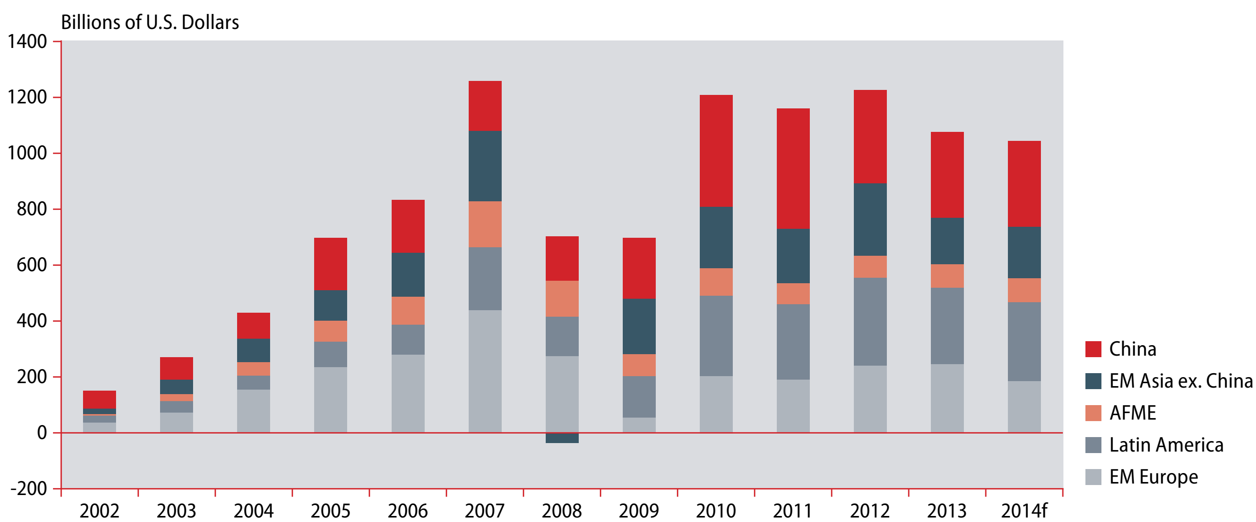


Chart 7
Private Capital Inflows to Emerging Economies – Regions

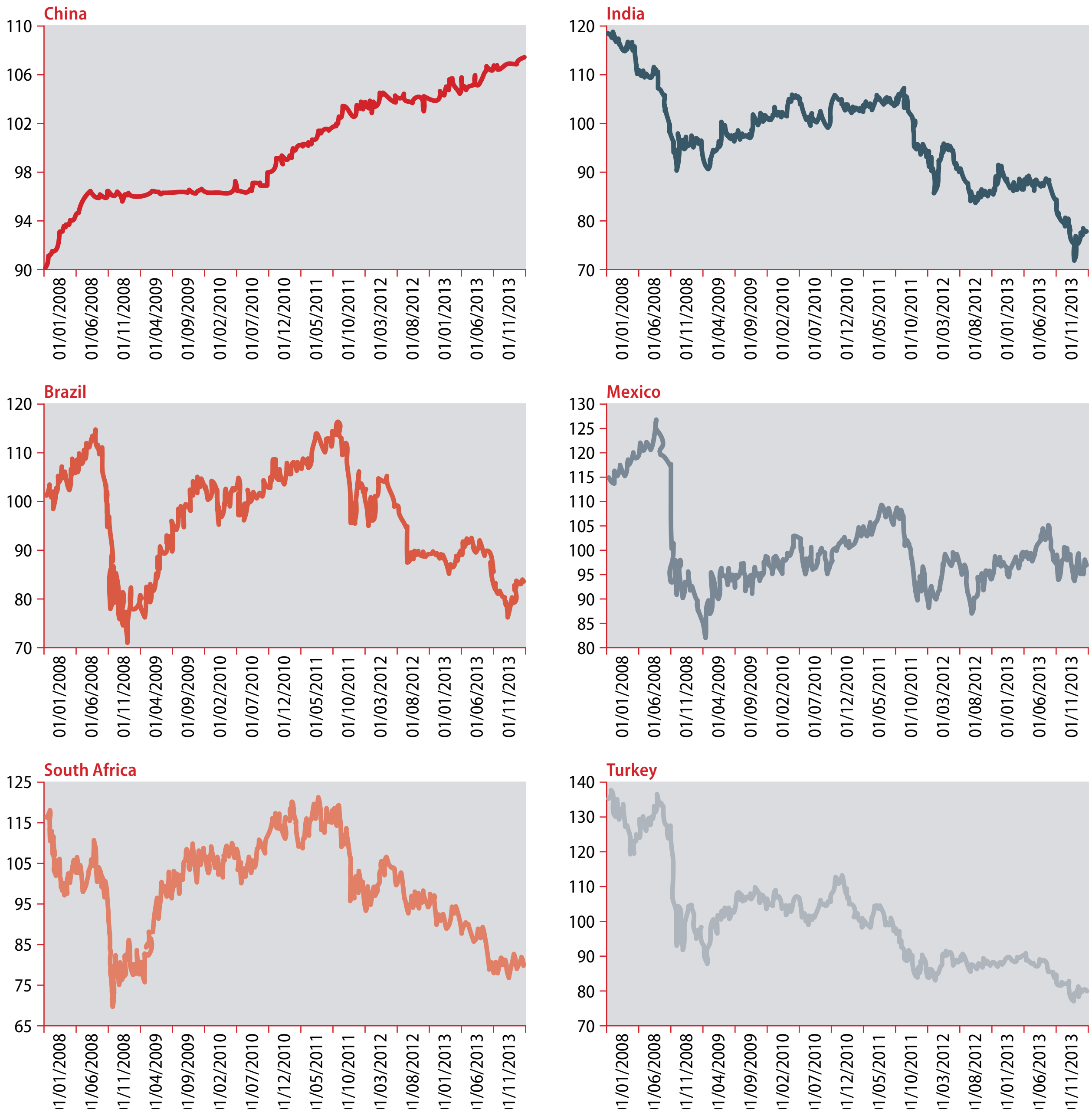


Source: IIF, October 2013.
Note: f=IIF forecast, e=estimate.

The surge in capital inflows led to a strong recovery in currency, equity and bond markets of major DCs which had come under severe pressures in the immediate aftermath of the Lehman collapse. While most DCs welcomed the recovery of capital inflows and the boom in asset prices they helped to generate, many of them, notably the deficit DCs, were ambivalent about the strong upward pressure they exerted on exchange rates (Chart 8). The ultra-easy monetary policies in AEs were seen as an attempt to achieve

Chart 8

Nominal Exchange Rates in Selected Economies (Period average=100)



Source: OANDA (http://www.onada.com).

Note: US dollar per unit of domestic currency.

beggar-thy- neighbour competitive devaluations to boost exports to drive recovery in conditions of sluggish domestic demand. It was described as a "currency war" by the Brazilian Minister of Finance while the Governor of the South African Reserve Bank alluded that DCs were in effect caught in a cross fire between the ECB and the US Fed (Marcus, 2012).

Most Asian DCs intervened heavily in foreign exchange markets, absorbing inflows in reserves and trying to sterilize interventions by issuing government debt. These countries avoided sharp appreciations. Others, particularly those pursuing inflation targeting, including Brazil, South Africa and Turkey, abstained from extensive interventions and experienced considerable appreciations. However, as upward pressures on the currencies of DCs persisted, there was an unprecedented resort to capital controls. Generally, market-friendly measures rather than direct restrictions were used, including reserve requirements, taxes and minimum stay periods.

These measures were designed not so much to prevent asset bubbles as to avoid currency appreciations. Generally, they were not very effective in limiting the volume of inflows as exceptions were made in several areas. In many cases the composition of inflows changed towards longer maturities and types of investment not covered by the measures. Furthermore, taxes and other restrictions imposed were too weak to match arbitrage margins.

It is true that the hands of some DCs are tied by bilateral investment treaties and free trade agreements with AEs which prohibit controls over capital flows. However, the half-hearted approach rather than international obligations played a major role in the failure to manage capital inflows effectively. For instance, despite the absence of such obligations Brazil was unable to avoid sharp appreciations of its currency and deterioration of its external payments while Korea managed inflows successfully and avoided appreciations despite being a member of the OECD and hence subject to the provisions of its Code of Liberalization of Capital Movements (Chamon and Garcia 2013; Singh 2010). In fact the Korean won has been one of the weakest currencies in the entire post-crisis period eliciting remarks that, together with the UK, it is the most aggressive "currency warrior" of the past five and a half years (Ferguson 2013).

Capital inflows to DCs have become weaker and unstable first with the deepening of the EZ crisis and subsequently with the prospect of the US Fed tapering the bond purchases under the QE3 programme. On the other hand, even though most developing economies have started to cool after 2011, many of them have seen their current account deficits widen. Thus, their need for foreign capital increased just as inflows have become weaker and unstable. These have led to a reversal of upward pressures on currencies and assets in several EEs. Capital controls over inflows have been dismantled and protests against ultra- easy monetary policies in AEs have vanished. Some countries have even introduced measures to attract foreign capital.

The EZ crisis has led to increased global risk aversion and greater preference for relatively safe assets. It has also impinged directly on the volume of global capital flows. Before the crisis, Europe was the main source of (gross) capital flows to the rest of the world, with $1600 billion per annum during 2004-07, higher than total outflows from the US and Japan taken together. With the outbreak of the crisis, total outflows from Europe fell sharply, registering a bare $300 billion a year during 2008-11.[15] The EZ crisis has also led to considerable short-term, month-to-month volatility in capital inflows to DCs which have become increasingly sensitive to news coming from the region.

Subsequently, in 2013, capital inflows have also become sensitive to statements by US Fed officials about bond purchases and economic data from the US. Ironically, weaker- than-expected growth and employment data have often lead to a rally in asset and currency markets of EEs, particularly those dependent on foreign capital, since they implied delays in tapering and normalization of monetary policy. This reflects that these countries are a lot more

15 IIF (January 2012). See also Lund et al. (2013) for the drop in cross-border claims by EZ banks.

exposed to financial shocks from tapering and monetary tightening than to trade shock from sluggish growth in the US.

The pronouncements by the Fed in May-June 2013 that it could start tapering in the summer triggered a hike in the 10-year Treasury bond yield, from 1.7 per cent to almost 3 per cent, and a reversal of capital inflows from DCs. However, subsequent weaker economic data led the Fed to postpone tapering and this gave a push to asset markets almost everywhere and to currencies of EEs. After relatively strong monthly job figures and increased concerns about the effectiveness and risks of QE, the Fed decided in December 2013 to gradually end its monthly purchases in the course of 2014, starting with a modest reduction of $10 billion in January, and tempered the taper by signalling that the policy rates would not likely be changed much before the end of 2015 (Cassidy 2013). The initial stock market reaction to the removal of uncertainty about tapering and the reassurance that historically low policy interest rates would stay two more years has been positive even though currencies in some EEs have come under a certain degree of pressure. While tapering itself is a cause of concern for EEs, notably in deficit and highly-indebted countries, the real risk for these economies lays in the Fed going beyond tapering and shifting from quantitative easing to quantitative tightening and from zero-bound to positive policy interest rates.

The nature of vulnerability of EEs to financial shocks from AEs has changed significantly in the past decade because of changes in the nature and composition of their external liabilities in the course of pre- and post-Lehman booms in capital inflows (Akyüz 2011b). Governments in EEs have increasingly shifted from external to domestic markets in meeting their financing needs, opening domestic bond markets to non-residents. As of end-2012 the size of local market debt in EEs, including corporate and sovereign debt, reached over $9.1 trillion and the share of non-resident holdings increased to an unprecedented 26.6 per cent, compared to 12.7 per cent in 2008, with this proportion exceeding 40 per cent in some (World Bank 2013). Higher interest rates and currency appreciations in EEs have played a significant role in attracting foreigners to local debt market by creating highly profitable carry-trade opportunities.

While increased foreign acquisition of local-currency securities has shifted the exchange rate and interest rate risks onto non-residents and reduced foreign exchange exposure of EEs, the greater foreign presence in domestic markets has also strengthened their link with international financial markets and heightened their vulnerability to external financial shocks. This is true even for countries with strong payments and reserve positions, as seen in Asia during the Lehman turmoil when several countries experienced sharp drops in domestic asset markets. Vulnerability is now greater because many carry-trade creditors and investors in local debt markets of EEs are highly leveraged and thus susceptible to changes in monetary conditions in the US.

By contrast, since the onset of the crisis, the exceptionally low interest rates in major AEs and low risk spreads have encouraged both financial and non-financial corporations of EEs to borrow abroad in reserve currencies, resulting in increased private sector exposure to interest rate and exchange rate instability (IMF 2013a; Oprita 2013). According to the BIS data, between 2010 and mid-2013, net external debt financing by EEs reached $1.9 trillion, of which over $1 trillion was in bonds and the rest in bank lending. Corporate bond issues during that period were $830 billion. These were undertaken mainly by non-financial corporations while banks in EEs relied primarily on international bank lending. Net bond issuance by corporations from EEs remained strong in the third quarter of 2013 despite the turbulence created by the expectations of tapering by the Fed (Turner 2013). As of mid-2013, bond issues by corporations from EEs in offshore financial centres exceeded issues by corporations from AEs (McCauley *et al* 2013).

Thus, several EEs are highly exposed to a shift to monetary tightening because of a rapid accumulation of private external debt and increased foreign presence in their domestic bond markets. Those with large current account deficits and strong capital inflows into their bond markets in recent years are particularly vulnerable. Indeed, in recent years, deficits in many of these countries have been increasingly financed by debt rather than equity. Many of these have also accumulated high levels of international reserves, but these could be drawn down quickly because they have been piled up from capital inflows (i.e., they are borrowed reserves) rather than earned from current account surpluses. Even countries with strong payments and reserves positions such as China can be hit hard by a hike in the long-term interest rates in the US because of growing international indebtedness of its corporations.[16] Three of the five BRICS countries that had been identified a decade ago by financial markets as the "emerging markets" with the brightest economic prospects, Brazil, India and South Africa, are now listed among the countries dubbed "fragile 5" by Morgan Stanley, with the addition of Turkey and Indonesia, again countries among the rising stars of recent years.

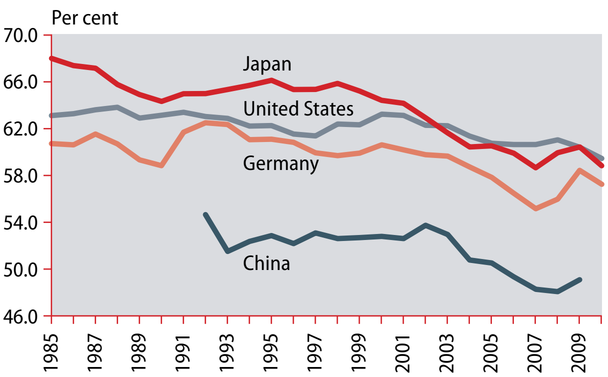
5 Longer-term prospects

Five years into the crisis, growth in the US remains sluggish, Europe is struggling to get out of recession and major emerging economies have slowed sharply after an initial resilience. Longer-term prospects are not very bright largely because the main problems that gave rise to the crisis, income inequalities, external imbalances and financial fragilities, remain unabated and have indeed been aggravated.

The world economy suffers from underconsumption because of low and declining share of wages in GDP in all major AEs including the US, Germany and Japan, as well as China (Chart 9).[17] Still, until the crisis the threat of global deflation was avoided thanks to consumption and property booms driven by credit and asset bubbles in the US and the EZ periphery. Several Asian DCs, notably China, also experienced investment and property bubbles while private consumption grew strongly in many DCs elsewhere, often supported by the surge in capital inflows. This process of debt-driven expansion created mounting financial fragility and trade imbalances, culminating in the Great Recession.

Chart 9

Wage Share as per cent of GDP, 1985-2010



Source: Eurostat.

The crisis has not removed but reallocated trade imbalances and widened the deflationary gap in the world economy. Germany has replaced China as the centre of global imbalances. It maintains a lid on domestic demand and creates a deflationary bias for the world economy as a whole as well as for the EZ (US Department of the Treasury 2013b). The crisis has also heightened income and wealth inequalities in the US and aggravated the underconsumption problem. In the EZ, the structural reforms being advocated are likely to extend wage suppression to the periphery and widen the deflationary gap. Finally, the crisis has produced new sources of financial fragility because of excessive reliance on ultra-easy monetary policy to fight the Great Recession. Under these conditions the likelihood for the world economy to move to a path of growth that is both stable and strong is slim.

Longer-term global prospects depend significantly on the US because of its central position in the world economy and the international reserves system. US growth is weak and fragile. There is a fear of a permanent demand gap and secular stagnation (Summers 2013; Krugman 2013). The US cannot easily shift

16 See Turner (2013) for channels of transmission of the effects of a sudden stop in international lending to domestic banking systems in EEs.

17 Financialization, welfare state retrenchment and globalisation of production are found to be the main reason; see Stockhammer (2012); see also Akyüz (2011a).

to a wage-led growth in the near future.[18] Nor can it shift to export-led growth, with exports growing vigorously and faster than domestic demand and the share of private consumption in GDP falling. Thus, a key question is if the US would be inclined to go back to "business as usual" and rely on credit and asset bubbles in search of strong growth.[19]

This is closely connected to its exit from the ultra-easy monetary policy. A full exit implies not only the end of zero-bound policy rates but also the normalization of the Fed's balance sheet a significant contraction of its size and a large shift of its asset composition back to short- and medium-term Treasuries. Although the Fed has announced that it would start tapering and terminate monthly bond purchases by late 2014, this does not mark the beginning of monetary tightening, as emphasized by Bernanke after the Fed meeting in December 2013 (Cassidy 2013). For one thing, policy rates are to remain at historical lows for some time to come, even after the unemployment rate falls below 6.5 per cent. For another, tapering would not reduce the level of long-term assets on the Fed's balance sheet but monthly additions to it. This means that the ultra-easy monetary policy is still with us, posing the risk of creating bubbles which untested macro-prudential regulations may not be able to prevent.

It is not clear when and how the Fed would start normalizing its balance sheet. Too gradual an exit whereby the Fed reduces its holding of long-term bonds as they mature would imply that the Fed's balance sheet would remain inflated and tilted towards long- term assets for several more years because of long maturities of the bonds held.[20] On the other hand, faster normalization of its balance sheet through liquidation of its bond holdings could pose several difficulties. According to projections of a recent report by the US Treasury, based on market expectations of the Fed's exit strategy, a tightening beginning in 2015 could raise the ten-year rate by 200 bp by 2018 and the average interest on government debt to 4.3 per cent over the next ten years (US Department of the Treasury 2013a). This could push the dollar up if other AEs do not follow suit and dampen growth. It could also lead to fiscal problems. Simulations made in the Fed and elsewhere assuming exit starting in 2015 and ending by 2018-19 show large income losses and declines in remittances to the Treasury.[21] All these explain why the Fed is unclear about normalizing its monetary policy; for, it may not be able to exit without market disruption and it cannot persist without creating bubbles. Uncertainty abounds because there are not many historical precedents for zero-bound interest rates and QE.

The longer-term prospects of the EZ are even less encouraging. Deleveraging and recovery in the periphery remain slow and many countries cannot be expected to recuperate output losses incurred after 2008 for several years to come. Even if the EZ avoids further turmoil, it would not generate much growth under the current policy approach. Pre-crisis growth in the EZ was mediocre, barely reaching 2 per cent per annum during 2002-07, and much of that was due to debt-driven expansion in the periphery. Post-crisis growth could even be slower.

The EZ periphery cannot go back to the spending spree and large current account deficits that culminated in the crisis. It needs payments adjustment based on

18 On wage-led growth, see Lavoie and Stockhammer (2012).

19 According to Summers (2013) and Krugman (2013) there is a deflationary gap and risk of secular stagnation because real interest rates cannot be brought down to (negative) levels needed to generate adequate spending due to zero lower bound on nominal interest rates and the inability of monetary authorities to raise inflation in markets for goods and services. They thus argue that inflation (bubbles) in asset markets may be necessary to close the deflationary gap and avert secular stagnation. However, a sound alternative would be to address the causes of the deflationary gap, notably increased inequality and underconsumption and fiscal orthodoxy. For a critique of this "Bubbleonian" growth, see Wray (2013).

20 According to Lenzner (2013) as a result of 4 years of QE, the Fed has accumulated 36 per cent of all Treasury securities between 5 years and 10 years in maturity plus 40 per cent of those government bonds over 10 years in maturity as well as 25 per cent of all the mortgage backed securities not owned by Fannie Mae and Freddie Mac.

21 See Carpenter et al. (2013) and Greenlaw et al. (2013). Both studies use the Blue Chip forecast for interest rates which puts the 10-year rate at close to 5 per cent at the end of the exit.

an expansion of exports as well as debt restructuring. However, it is locked in a currency whose nominal exchange rate is beyond its control. Consequently, in the absence of a significant shift of policy in Germany to allow appreciation of its real effective exchange, the only way for the periphery to restore competitiveness would be by cutting wages. So far a certain degree of internal devaluation has been achieved through wage suppression and adjustment in unit labour costs. There are also significant improvements in current accounts in the periphery largely due to cuts in investment and imports (Atoyan *et al.* 2013). Unemployment would need to remain high in order for wages to be kept under control and for unit labour costs to continue declining. This may face serious social and political obstacles and could eventually lead to default and exit.

Finally, the fortunes of many DCs depend crucially on China. The crisis marks the end of spectacular export-led growth in China. Its response has served to rebalance domestic and external demand, but aggravated the imbalance between investment and consumption which had already been building up before the crisis. Despite the recognition of the problem of underconsumption and low share of household incomes in GDP, the distributional rebalancing is progressing very slowly and consumption has been growing only marginally faster than income. China cannot keep on pushing investment to fill the deflationary gap created by the slowdown in exports. That would aggravate financial fragility and internal imbalances. Nor can it go back to pre-crisis export-led growth. This would be resisted by its trading partners, possibly causing disruptions in the trading system.

The most likely medium-term scenario for China is a sizeable drop in its trend growth compared to double-digit rates it enjoyed in the run-up to the crisis, with a better balance between domestic and external demand and a gradual rebalancing of domestic consumption and investment. A transition to slower growth is already under way and on some accounts the growth rate would come down to 6.5 per cent during 2018-22 after three decades of double-digit levels (Wolf 2013b). China seems to have come to terms with such a slowdown with its Finance Minister pointing out that 6.5 per cent growth would not be a big problem for it (Bloomberg 2013).

The transition of China to a lower growth path and a rebalancing of its domestic demand towards consumption would imply slower growth of its demand for commodities. This means that China would cease to be a strong locomotive for commodity exporters. Not only Latin American but also Sub-Saharan African countries are highly vulnerable to a permanent slowdown in Chinese investment. According to a recent estimate, a 1 percentage point increase in China's domestic investment growth is associated with an average 0.6 percentage points increase in SSA countries' export growth and the impact is larger for resource-rich countries, especially oil exporters (Drummond and Liu 2013). From 2002 to 2012 China's domestic investment grew on average by around 13 per cent per annum. A rebalancing in China would call for a sizeable fall in its share in GDP. This would mean a decline of some 8 percentage points in its average annual growth. On the basis of the estimates above, this could cut export growth of SSA by some 5 percentage points.

Nor can China be expected to become a locomotive for exporters of manufactures in the South. Since its imports of manufactures from DCs are destined mainly for exports rather than for domestic consumption, a greater balance between exports and domestic consumption would imply slower growth of imports of parts and components from other DCs. On the other hand, although there are instances of relocation of low-skill, labour- intensive production in some sectors to lower-wage DCs in Asia through Chinese FDI, there is still some time before China could exit from such industries and a Flying Geese type of process could pick up momentum.

6 Conclusions

Not only has the "Great Recession" led to a "Great Slowdown" in DCs (Economist 2012), but also the medium-term prospects for global economic conditions look quite unfavourable to DCs not only in comparison with pre-crisis years, but also in some respects the period since the onset of the crisis. Thus, the rapid rise of the South that began in the early years of the new millennium appears to have come to an end. This should not come as a surprise since the exceptional performance of DCs in the run up to the crisis was driven primarily by highly favourable but unsustainable global conditions.

Of major DCs only China promises sustained catch-up growth and graduation even though it faces a bumpy road. Brazil and South Africa continue to depend heavily on commodities and have indeed deepened their dependence by expanding the commodity sector relative to industry. The two key determinants of growth in Latin America and Africa, commodity prices and capital flows, are largely beyond national control and susceptible to sharp and unexpected swings. At a bare 3 per cent, as estimated by the (IMF 2013b), the average potential growth rate of Latin America is far too low to close the income gap with AEs. Many Asian middle-income countries face growing competition from below without being able to upgrade and join those above, Korea, Taiwan (China) and Singapore. India has been relying on the supply of labour to the rest of the world, not by converting them into higher-value manufactures, but by exporting unskilled workers and labour services of a very small proportion of its total labour force (Nabar-Bhaduri and Vernengo 2012).

The remarkable growth performance of most DCs in the past decade is in danger of remaining a "one-off success" unless they raise productive investment, accelerate productivity growth and make significant progress in industrialization. Despite growing disillusionment in the South, the Washington Consensus is dead only in rhetoric. There is little roll back of the policies introduced on the basis of that consensus in the past two decades. On the contrary, the role and impact of global market forces in the development of DCs has been greatly enhanced by continued liberalization of trade, investment and finance unilaterally or through bilateral agreements with AEs and this has narrowed the policy space of DCs and heightened their exposure to external shocks.

DCs need to be as selective about globalization as AEs and reconsider their integration into the global economic system, in recognition that successful policies are associated neither with autarky nor with full integration, but strategic integration designed to use foreign finance, markets and technology in pursuit of development. This implies rebalancing external and domestic forces of growth and reducing dependence on foreign markets and capital. The role of the state and markets needs to be redefined in all key areas affecting development, keeping in mind that in most cases catch-up is not possible without industrialization and industrialization is not possible without active policy.

Beyond these long-lasting policy challenges, DCs may also face strong external destabilizing and deflationary shocks over the coming years for the reasons discussed above, notably tightened global financial conditions, hikes in interest rates and external debt burden, and capital flight, in addition to protracted weaknesses in AEs and sluggish international trade. Policies that would need to be pursued by DCs and the international community in response to such adverse developments are not very much different from those recommended by this author in the early days of the global financial crisis (Akyüz 2009).

The principal objective of a policy response of DCs to a possible tightening of the balance-of-payments constraint should be to minimize its impact on growth and employment. There can be little doubt that trade-restricting measures should be avoided since this would simply deepen global deflation. However, DCs should not be denied the right to use legitimate trade measures to rationalize imports through selective restrictions in order to allocate scarce foreign exchange to areas most needed, particularly for the import of intermediate and investment goods and food.

The DCs should be encouraged to use temporary exchange restrictions and debt standstills in the event of a strong and sustained capital flight triggered by the exit of the US from the ultra-easy monetary policy. These measures should be supported by the IMF, where necessary, through lending into arrears. Such lending should not serve to bail out creditors but to maintain income and employment in the countries concerned. Any additional financing that DCs may need should come without procyclical macroeconomic conditionality. Considerations should be given to a large scale SDR allocation, including reversible allocations, to DCs most affected by a contraction in global liquidity.

The world economy is facing bleak prospects largely because the systemic shortcomings in the global economic and financial architecture that gave rise to the most serious post-war crisis remain unabated. The Outcome Document of the 2009 UN Conference on the "World Financial Crisis and Economic Crisis and Its Impact on Development" had clearly recognized that "long standing systemic fragilities and imbalances" were among the principal causes of the crisis and proposed "to reform and strengthen international financial system and architecture" so as to reduce the likelihood of the occurrence of such crises (UN 2009). It pointed to many areas where systemic reforms are needed including regulation of "major financial centres, international capital flows, and financial markets", the international reserves system with a view to exploring the scope for a greater role for the SDR, the international approach to the debt problems of DCs, and the mandates, policies and governance of international financial institutions. However, so far the international community has failed to address any of these issues in a significant way.

DCs need not only a stable global economic environment, but also greater policy space to achieve industrialization and development. This calls for a fundamental rethinking of multilateral disciplines in trade, investment and technology. Although in legal terms the WTO rules and commitments provide a level playing field for all parties, they are designed primarily to accommodate the development trajectories of AEs. Effective constraints they impose over national policies are much tighter for DCs, particularly those at intermediate stages of industrialization. The policy space of these countries is considerably narrower than that enjoyed by today's advanced economies in the course of their industrialization because of the tendency of those who reach the top to "kick away the ladder" and deny the followers the kind of policies they had pursued in the course of their development. This needs to be put right by restructuring multilateral disciplines in key areas of policy affecting industrialization and development including industrial tariffs and subsidies, trade-related investment measures, intellectual property rights, transfer of technology and trade in services (Akyüz 2010).

Industrial, macroeconomic and financial policies of DCs are also severely constrained by bilateral investment treaties and free trade agreements with AEs. These are designed on the basis of a corporate perspective rather than a development perspective and they give considerable leverage to transnational corporations and investors in DCs. These too need to be revised or dismantled.

The international community need to move from donor-centric view of development with a focus on poverty and aid to development proper (Akyüz 2013b). For this to happen, systemic reforms needed to improve the governance and stability of the global economy and to widen the boundaries of policy intervention in developing countries should become the key components of the post-2015 agenda.

References

Akyüz, Y. (2006). *From Liberalization to Investment and Jobs: Lost in Translation.* Working Paper 74, July. Policy Integration Department, ILO, Geneva.

Akyüz, Y. (2009). Policy Response to the Global Financial Crisis. South Centre Research Paper 24, May. Printed in Akyüz (2012b).

Akyüz, Y. (2010). Multilateral Disciplines and the Question of Policy Space. In *International Economic Law, Globalization and Developing Countries*, ed. by J. Faundez and C. Tan, Edward Elgar, 2010.

Akyüz, Y. (2011a). Global Economic Prospects: The Recession May be Over but Where Next? *Global Policy,* May.

Akyüz, Y. (2011b). Capital Flows to Developing Countries in a Historical Perspective: Will the Current Boom End with a Bust? South Centre Research Paper 37, March. Printed in Akyüz (2012b). Akyüz, Y. (2012a). The Staggering Rise of the South? South Centre Research Paper 44, March.

Akyüz, Y. (2012b). The Financial Crisis and the Global South. A Development Perspective. Pluto Press, London,

Akyüz, Y. (2013a). Waving or Drowning: Developing Countries after the Financial Crisis. South Centre Research Paper 48, June, Geneva.

Akyüz, Y. (2013b). Post-2015 Development Agenda and Sustainable Development, South Views 66, 12 July. http://www.Southcentre.int/category/publications/Southviews/

Amadeo, K. (2013). What was the Stimulus Package? About.com US Economy, 10 September. http://useconomy.about.com/od/candidatesandtheeconomy/a/Obama_Stimulus.htm?p=1 (Accessed 10 November 2013).

Atoyan, R., J. Manning, and J. Rahman (2013). Rebalancing: Evidence from Current Account Adjustment in Europe. IMF Working Paper WP 13/74, Washington, D.C.

Baldursson, F. M. and R. Portes (2013). Capital controls and the Resolution of Failed Cross-Border Banks: The Case of Iceland. Vox, 12 November. http://www.voxeu.org/article/iceland-s-capital-controls (Accessed 23 November 2013).

Bernanke, B. (2002). Deflation: Making Sure "It" Doesn't Happen Here. Remarks, National Economists Club, Washington, D.C. November 21, www.federalreserve.gov/newsevents/speech/2002speech.htm (Accessed 13 January 2013).

Bernanke, B. (2013). Monitoring the Financial System. Speech at the 49th Annual Conference on Bank Structure and Competition sponsored by the Federal Reserve Bank of Chicago, Chicago, Illinois, May 10. http://www.federalreserve.gov/newsevents/speech/bernanke20130510a.htm (Accessed 12 May 2013)

BIS (2013). Quarterly Review. International Banking and Financial Market Developments. September. Blanchard, O. and D. Leigh (2013). Growth Forecast Errors and Fiscal Multipliers, IMF Working Paper 13/1, Washington D.C.

Blinder, A. S, and M. Zandi (2007). How the Great Recession was Brought to an End. http://www.economy.com/mark-zandi/documents/end-of-great-recession.pdf (Accessed 3 January 2013).

Bloomberg (2013). China Can Endure Growth Slowdown to 6.5%, Finance Chief Says. http://www.bloomberg.com/news/2013-07-12/china-finance-chief-lou-says-6-5-growth-wouldn-t-pose-problem.html. (Accessed 15 July 2013).

Bowers, S. (2013). Iceland Rises from the Ashes of Banking Collapse. The Guardian, 6 October.

Canuto, O., M. Cavallari, and J. G. Reis (2013): "Brazilian Exports, Climbing Down a Competitiveness Cliff", World Bank Policy Research Working Paper 6302, January.

Carpenter, S., J. Ihrig, E. Klee, D. Quinn, and A. Boote (2013). The Federal Reserve's Balance Sheet and Earnings: A primer and projections. Finance and Economic Discussion Series, Federal Reserve Board, Washington D.C., January. http://www.federalreserve.gov/pubs/feds/2013/201301/201301pap.pdf (Accessed 13 December 2013).

Cassidy, J. (2013). Bernanke Takes away the M and Ms but Leaves the Snickers Bars. The New Yorker, December 18. http://www.newyorker.com/online/blogs/johncassidy/2013/12/what-did-the-fed-do- whats-a-taper-and-is-ben-bernanke-a-genius-or-an-idiot.html (Accessed 20 December 2013).

Chamon, M. and M. Garcia (2013). Capital; Controls in Brazil: Effective? PUC Discussion Paper, 606. January.

Cohen, D. (2013). Resilient Job Market Puts Fed Tapering Back on Table. Brookings on Job Numbers. www.brookings.edu/blogs/jobs/posts/2013/11/08-resilient-job-market-fed-tapering-cohen (Accessed 9 November 2013)

Conference Board (2013). The Conference Board Economic Forecast for the US Economy, March 13. https://hcexchange.conference-board.org/pdf_free/economics/2013_03_131.pdf (Accessed 18 March 2013).

Curdia, V. and A. Ferrero (2012). How Stimulatory are Large-Scale Asset Purchases? Economic Letter, Federal Reserve Bank of San Francisco August, 2013-22

De Grauwe, P. (2010). Fighting the Wrong Enemy. Vox, 19 May. http://www.voxeu.org/article/europe-s- private-versus-public-debt-problem-fighting-wrong-enemy (Accessed 24 September 2012).

Dobbs, R., S. Lund, T. Koller, and A. Shwayder (2013). QE and Ultra-low Interest Rates: Distributional Effects and Risks. McKinsey Global Institute, November. http://www.mckinsey.com/insights (Accessed 15 November 2013).

Drummond, P., and E. X. Liu (2013). Africa's Rising Exposure to China: How Large Are Spillovers Through Trade? IMF Working Paper 13/250, November.

Economist (2012). The Great Slowdown, 21 July. http://www.economist.com/node/21559339 (Accessed 12 January 2013).

Ferguson, N. (2013). Currency wars are best fought quietly. Financial Times, Opinion, 25 January. http://www.ft.com/intl/cms/s/0/cdc80aa0-6638-11e2-b967-00144feab49a.html#axzz2PDTzy8AU (Accessed 23 March 2013).

Financial Times (2012). Editorial: Waiting for Growth. Bank of England must get its Money into the Economy. 12 August.

Fontevecchia, A. (2013). Janet Yellen: No Equity Bubble, No Real Estate Bubble, And No QE Taper Yet. Forbes, 14 November. http://www.forbes.com/sites/afontevecchia/2013/11/14/janet-yellen-no-equity-bubble-no-real-estate-bubble-and-no-qe-tapering-yet/ (Accessed 23 November).

Giles, C. (2013). IMF changes tune on global economic assessment. Financial Times, September 4.

Greenlaw, D., J.D. Hamilton, P. Hooper, and F.S. Mishkin (2013). Crunch Time: Fiscal Crises and the Role of Monetary Policy. July 29. http://dss.ucsd.edu/~-jhamilto/USMPF13_final.pdf (Accessed 13 December 2013).

Griffith, J. (2012). Bipartisan Bill Pushes Shared Appreciation Principal Reductions, Centre for American Progress, June 12. www.americanprogress.org/issues/housing/news/2012/06/12/11806/bipartisan-bill-pushes-shared-appreciation-principal-reductions/ (Accessed 12 June 2013).

Gros, D. (2011). External versus domestic debt in the euro crisis. 24 May. www.voxeu.org/article/external- versus-domestic-debt-euro-crisis (Accessed 2 March 2013)

Hamilton Project (2013). Closing the Jobs Gap. http://www.hamiltonproject.org/jobs_gap/ (Accessed 10 December 2013).

Herndon, T., M. Ash and R. Pollin (2013). Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff. PERI Working Paper 322, University of Massachusetts, Amherst, April 15.

Higgins, A. (2013). Cyprus Bank's Bailout Hands Ownership to Russian Plutocrats. The New York Times, 21 August.

IIF (Institute of International Finance) (various issues). Capital Flows to Emerging Market Economies. http://www.iif.com/.

IMF WEO (various issues). *World Economic Outlook*, Washington, D.C.

IMF (2011). Euro Area Policies: Spillover Report for the 2011 Article IV Consultation and Selected Issues. Country Report No. 11/185, July. Washington, D.C.

IMF (2012). 2012 Spillover Report, July 9, Washington, D.C.

IMF (2013a). Global Financial Stability Report, April, Washington, D.C.

IMF (2013b). Regional Economic Outlook. Western Hemisphere. Time to Rebuild Policy Space, May, Washington, D.C.

IMF (2013c). Greece: Export Evaluation of Exceptional Access under the 2010 Stand-By Arrangements. Country Report No. 13/156, June.

IMF (2013d). Global Impact and Challenges of Unconventional Monetary Policy. Policy paper, October 7, Washington D.C.

Krugman, P. (2013). Secular Stagnation, Coalmines, Bubbles, and Larry Summers. The New York Times, Opinion Pages, November 16. http://krugman.blogs.nytimes.com/2013/11/16/secular-stagnation- coalmines-bubbles-and-larry-summers/?_r=0#more-35994 (Accessed 18 November 2013).

Lapavitsas, C., A. Kaltenbrunner, G. Lambrinidis, D. Lindo, J. Meadway, J. Michell, J.P. Painceira, E. Pires, J. Powell, A. Stenfors, and N. Teles (2010). The Eurozone between Austerity and Default, RMF Occasional Report, September. www.researchonmoneyandfinance.org (Accessed 12 January 2013).

Lavoie, M. and E. Stockhammer (2012). Wage-led growth: Concept, theories and policies. Conditions of Work and Employment Series 41, ILO, Geneva

Lenzner, R. (2013). I Bet You Didn't Know The Fed Owns 40% of All Treasuries Over 5 Years in Maturity. Forbes, 25 November. www.forbes.com/sites/robertlenzner/2013/11/25/the-fed-has-been- cornering-the-treasury-market-for-the-past-four-years/ (Accessed 17 December 2013).

Lund, S., T. Daruvala, R. Dobbs, P. Härle, J-H. Kwek and R. Falcón (2013). Financial Globalization. Retreat or Reset. March. http://www.mckinsey.com/insights/global_capital_markets/financial_globalization (Accessed 25 March 2013).

Marcus, G. (2012). Consider the small nations caught in the central bank crossfire. Financial Times, May 3.

Massa, I., J. Keane, and J. Kennan (2012). The euro zone crisis and developing countries, Working Paper 345, Overseas Development Institute, London.

McCauley, R.N., C. Upper and A. Villar (2013): Emerging market debt securities in offshore centres. BIS Quarterly Review, September, pp. 22-23.

Nabar-Bhaduri, S., and M. Vernengo (2012). Service-led growth and the balance of payments constraint in India: An unsustainable strategy. University of Utah, Department of Economics Working paper 2012-06, June. http://economics.utah.edu/publications/2012_06.pdf (Accessed 16 January 2012).

OECD (2012). Economic Outlook, 92, November, Paris.

Oprita, A. (2013). IMF warns on emerging markets corporate debt. Emerging Markets. 17 April. http://www.emergingmarkets.org/Article/3192541/IMF-warns-on-emerging-markets-corporate- debt.html (Accessed 4 May 2013).

Ortiz, I. and P, Cummings (2013). The Age of Austerity – A Review of Public Expenditures and Adjustment Measures in 181 Countries. IPD and South Centre Working Paper, March.

Palley, T.I. (2013). Europe's Crisis without End: The Consequences of Neoliberal Run Amok. Macroeconomic Policy Institute (IMK) Working Paper, 111, March, Dusseldorf, Germany.

Piketty, T., E. Saez, and S. Stantcheva (2011). Taxing the 1%: Why the Top Tax Rate Could be Over 80%. Vox, 8 December. http://www.voxeu.org/article/taxing-1-why-top-tax-rate-could-be-over-80 (Accessed 2 December 2013)

Reinhart, C.M. and K.S. Rogoff (2010). Growth in a Time of Debt. NBER Working Paper 15639

Reuters (2012). IMF chief economist says crisis will last a decade. October 3. www.reuters.com/assets/print?aid=USL6E8L34VH20121003 (Accessed 6 October 2012).

Reuters (2013a). Too few European Banks Have Been Wound Down – EBA's Enria, 18 November. http://uk.reuters.com/article/2013/11/18/uk-europe-banks-idUKBRE9AH05X20131118 (Accessed 19 November 2013).

Reuters (2013b). Iceland government launches debt relief package for households. November 30. www.reuters.com/article/2013/11/30/iceland-debt-idUSL5N0JE28K20131130 (Accessed 2 December 2013).

Roubini, N. (2013). The Trapdoors at the Fed's Exit. Economonitor, April 29. www.economonitor.com/blog/2013/04/the-trapdoors-at-the-feds-exit/ (Accessed 30 April 2013).

Saez E. (2012). Striking it Richer: The Evolution of Top Incomes in the United States (Updated with 2009 and 2010 estimates), March 2 http://elsa.berkeley.edu/~saez/saez-UStopincomes-2011.pdf (Accessed 4 March 2013).

Singh, K. (2010). Financial Crisis Conducive to Instability of Asia's Currency Markets: South Korea Imposes Currency Controls. Global Research 23 June. http://www.globalresearch.ca/financial-crisis-conducive- to-instability-of-asia-s-currency-markets-south-korea-imposes-currency-controls/19857 (Accessed 25 June 2010).

Sinn, H-W. (2011). Germany's capital exports under the euro. Vox, 2 August. www.voxeu.org/article/germany-s-capital-exports-under-euro (Accessed 24 September 2012).

Stein, J.C. (2013). Overheating in Credit Markets: Origins, Measurement, and Policy Responses. Remarks at the research symposium sponsored by the Federal Reserve Bank of St. Louis, St. Louis, Missouri www.federalreserve.gov/newsevents/speech/stein20130207a.pdf (Accessed 12 October 2013).

Stiglitz, J.E. (2013). Inequality Is Holding Back the Recovery. The New York Times Opinionator, 19 January. http://opinionator.blogs.nytimes.com/2013/01/19/inequality-is-holding-back-the-recovery/ (Accessed 3 March 2013).

Stockhammer, E. (2012). Why have wage shares fallen? A panel analysis of the determinants of functional income distribution. Conditions of Work and Employment Series No. 35, ILO, Geneva.

Summers, L.H. (2013). IMF Economic Forum. Policy Responses to Crises, Washington, D.C. 8 November. http://larrysummers.com/video/ (Accessed 21 November 2013).

Turner, A. (2013a). Debt, Money and Mephistopheles: How do we get out of this Mess? Annual address, Cass Business School, 6 February. www.fsa.gov.uk/library/communication/speeches (Accessed 14 February 2013).

Turner, A. (2013b). Overt Monetary finance and Crisis Management. Project Syndicate, August 10. www.project-syndicate.org/print/overt-monetary-finance-and-crisis-management-by-adair-turner (Accessed 23 August 2013)

Turner, P. (2013). The global long-term interest rate, financial risks and policy choices in EMEs. Paper presented at the Inter-American Development Bank's XXXVIII Meeting of Chief Economists of Central Banks and Finance Ministries, Washington, DC 9–10 October.

UN (2009). Resolution adopted by the General Assembly on 9 July 2009 63/303. Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development, A/RES/63/303.

UNCTAD TDR (Various issues). Trade and Development Report. United Nations: Geneva

UNCTAD (2009). Global economic crisis: implications for trade and development Report by the UNCTAD secretariat, TD/B/C.I/CRP.1. 7 May.

UN WESP (2013). World Economic Situation and Prospects, United Nations, New York, January.

US Department of the Treasury (2013a). Fiscal Year 2013 Q2 Report. Office of Debt Management. Treasury Borrowing Advisory Committee Discussion Charts by Calendar Year. 2013 Second Quarter. http://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Pages/TBAC- Discussion-Charts.aspx (Accessed 10 May 2013).

US Department of the Treasury (2013b). Report to Congress on International Economic and Exchange Rate Policies. Office of International Affairs, October 30. www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/2013-10-30_FULL%20FX%20REPORT_FINAL.pdf (Accessed 8 November 2013)

Wall Street Journal (2011). Bernanke Rejects Bailouts. http://online.wsj.com/news/articles/SB10001424052748704739504576067602380461160 (Accessed 14 November 2011).

Warren, E. (2013). Americans for Financial Reform and the Roosevelt Institute, Speech delivered at the Roosevelt Institute, Washington, DC, and November 12. www.warren.senate.gov/files/documents/AFR%20Roosevelt%20Institute%20Speech%202013-11-12.pdf (Accessed 14 November 2013).

Weisbrot, M., and H. Jorgensen (2013). Macroeconomic Policy Advice and the Article IV Consultations: A European Union Case Study. Center for Economic Policy Research, January.

White, W.R. (2012) Ultra Easy Monetary Policy and the Law of Unintended Consequences Federal Reserve Bank of Dallas Globalization and Monetary Policy Institute Working Paper No. 126, September. http://www.dallasfed.org/assets/documents/institute/wpapers/2012/0126.pdf (Accessed 8 February 2013).

White, W. (2013). Overt Monetary Financing (OMF) and Crisis management Project Syndicate, June 12. www.project-syndicate.org/print/overt-monetary-financing--omf--and-crisis-management(Accessed23August2013).

Wolf, M. (2013a). The Case for Helicopter Money. Financial times, 12 February. Wolf, M. (2013b). Why China's economy might topple. Financial times, 2 April.

World Bank (2013). Recent developments in local currency bond markets (LCBMs). October. www.g20.org/load/783687600 (Accessed 8 November 2013).

Wray, L.R. (2013). Bow down to the Bubble: Larry Summerian Endorses Bubbleonian Madness and Paul Krugman Embraces the Hansenian Stagnation Thesis. New Economic Perspectives, 21 November. http://neweconomicperspectives.org/2013/11/bow-bubble-larry-summerian-endorses-bubbleonian-madness-paul-krugman-embraces-hansenian-stagnation-thesis.html (Accessed 22 November 2013).

Yellen, J.L. (2013a). A Painfully Slow Recovery for America's Workers: Causes, Implications, and the Federal Reserve's Response. Remarks made at "A Trans-Atlantic Agenda for Shared Prosperity", conference sponsored by the AFL-CIO, Friedrich Ebert Stiftung, and the IMK Macroeconomic Policy Institute Washington, D.C., 11 February. http://federalreserve.gov/newsevents/speech/yellen 20130211a.htm (Accessed 14 February 2013).

Yellen, J.L. (2013b). Speech at the "Rethinking Macro Policy II", a conference sponsored by the International Monetary Fund, April 16, Washington, D.C. Board of Governors of the Federal Reserve System, http://www.federalreserve.gov/newsevents/speech/yellen20130416a.htm (Accessed 19 April 2013).