

SIFA Special Lecture on
"Impending Threats to the Global Economic Order"

By

Professor Dr. Joseph E. Stiglitz

At

Ministry of Foreign Affairs, Bangkok, Thailand

January 7, 2005

It is a real pleasure to have this opportunity to talk to you. The title that I have chosen, "Impending Threats to the Global Economic Order," is not usual fare for an after dinner speech, which is supposed to be marked by humor. So that will be the last bit of humor in this talk.

I want to begin my remarks about the Tsunami by discussing how it has demonstrated the power and scope of globalization.

Everyone in the world has been touched by what has happened. The amazing expansion of global tourism has meant that it is not just people who live in the region but also people all over the world who have been affected. TV, too, has brought pictures of the nature of the devastation into the homes of people everywhere in the world. The response—issuing from the Earth's four corners—has also demonstrated some of the impressive powers of globalization. Global pressure, if only due to perception, has pushed country after country to increase their contributions to help those affected by the tsunami. The challenges to the countries in the region themselves are of course enormous, and it is impressive to see how strongly they have responded.

I have been spending the last couple of weeks working in Bali, which as you know may be not quite as nice as the southern part of Thailand, but still has its virtues. What struck me is that Bali has an extremely strong civil society. There are signs everywhere about making contributions to help in the wake of this terrible disaster. In another part of Indonesia I went to a dinner party and, again, there were people making significant donations. The extremely strong and responsible civil society on the island was raising money for their fellow citizens. I also think that as this international disaster is crossing a large number of countries, it was appropriate for the UN to take the leading role. I am very pleased that it has risen to that occasion.

I want to now share with you some other concerns that I have about the global economic situation. There are three, given the limited amount of time, that I would like to talk about. The first one is obvious and goes beyond economics but also encompasses economics, which is a concern about unilateralism, and particularly unilateralism in a world where there is an increasing commitment to democracy. The rhetoric and belief in democracy has spread all over the world, so there is a belief that decisions involving collective interests ought to be done in a democratic way. To me the lack of congruity between this deep-felt belief in democracy and unilateralism is an impending threat. I want to talk about it here only in the context of economics.

It is a danger largely because with unilateralism there is a tendency to push a particular single approach to development in an economy. However, it should be clear that a single approach will not work well for all countries. In part, it is also a concern that there is a tendency for whoever is the unilateral power to think that what is good for it is

good for the rest of the world. There was an expression by the President of General Motors, in which he said what is good for the US is good for General Motors; that was probably true. But then he went on to say that what is good for General Motors is good for the US, which may or may not be true. We were talking at dinner earlier about how General Motors has played an important role in suppressing public transportation systems in the US because they want to sell more cars. In this case, what is good in the short run for General Motors has been bad for the environment and society.

Similarly, there is a tendency for a country trying to take a unilateralist approach to think that what is good for it is good for the world. There are, in fact, many different visions of what a good society is and what will function well as an economy. There are even many different forms of capitalism: Swedish capitalism, American capitalism, even Russian capitalism. Each in their own way may be successful. Sweden, for instance, has had growth every bit as strong as that of the US, and yet, social indicators - life expectancy, inequality, poverty - are all far better in Sweden than they are in the US. It is important to recognize that even in America there is a debate about the adequacy of the American system of capitalism, of market fundamentalism, because there is a tendency for too many countries to try to emulate what I think of as a system that has obviously a number of virtues but also some very important flaws, including problems of health, inequality, and poverty.

One of the dangers is that we often measure success in the wrong way. We talk about growth in terms of GDP, and obviously we all recognize that this measurement of output does not incorporate many other important aspects of societies. Indeed, in one of the countries not too far from here, Bhutan, the King has put forward a very interesting notion of maximizing GNH, Growth National Happiness. GDP does not measure the depletion of natural resources or the deterioration of the environment. There are many other things that ought to be measured, but perhaps one of the most important things is that it does not tell you how well the typical citizens in a country are doing.

GDP going up does not necessarily mean that people are getting better off. There is a dramatic example of that in the US in the last 4 years. GDP has actually increased, not at a rapid rate and not at a rate equal to its potential, but each of the years it has gone up 1%, 2%, 3% and the last year 4%. But, the income in real terms over the last four years of the representative American family has actually decreased by \$1,500, so the representative American is now poorer. We may have a rich country, but it is filled with poor people. Of course, the reason for this is very simple. All the growth is going to the people at the very top, and the average American is becoming—relatively speaking—poorer and poorer.

The danger of unilateralism is that it pushes one particular view of the market economy of capitalism, which may not be well suited for many other countries. It may not be what other countries want. That leads me to the second issue, one which is of some relevance to the discussions going on here in Thailand, which is the proliferation of bilateral trade agreements. This, particularly, became a serious problem after the failure of Cancun.

I want to say a few remarks about the failure of the trade negotiations that occurred in the WTO meeting that was held in Cancun in September of 2003. Most of you know the history of those trade negotiations: there was supposed to be the beginning of a new round of trade negotiations in Seattle in December of 1999. President Clinton was particularly enthusiastic about that. Typically, rounds of trade negotiations are named after the city where they

began, and so it is possible that this would have been remembered as the Seattle Round, with Clinton getting some credit for it. There are even some instances where the round of negotiations is named after the President, like the Kennedy Round, so President Clinton hoped that this would be called the Clinton Round. All we remember now are the Seattle riots.

At the time a lot of people were surprised because they thought: this is very strange, trade globalization has brought enormous benefits to everybody around the world. Some economists say this discontent with globalization is really not a problem for economists, but for psychiatrists. The problem, they claimed, is that people are better off but just do not know it, so how can we make them understand how much better off they are? As it turned out, studies at the UNDP and the World Bank actually said that they had a reason to be unhappy, because the poorest countries around the world were actually made worse off by the Uruguay Round. In particular, the countries of Sub-Saharan Africa as a region were actually worse off as a result of the Uruguay Round. What many developing countries were worried about, therefore, was whether the same thing would happen again.

The natural response was that they decided to have a meeting at a place where it is more difficult to protest: Doha. They also said this would be a development round. Two years later, it was not a development round. The US walked away from the commitments that it made in agriculture, and Europe followed, walking away as well. Progress in intellectual property and in other areas was not what had been promised and hoped for. In terms of agriculture, most of the people thought that what they could get out of the US was, at the least, a return to where things were in 1994. After 1994 the understanding was that subsidies on agriculture would be cut back; instead, the US doubled the subsidies. Thus, the big concession was to bring them back to where they were before, which was obviously unsatisfactory.

In the aftermath of that I was asked to speak by the Commonwealth of Nations, a very interesting grouping of countries. It is one forum in which both developed and developing countries get together and talk about a whole variety of issues of common interest. The Commonwealth asked me to write a report on what would be a *true* development round. In other words, I was asked to describe a trade agenda that would promote the well-being of the developing countries, promote development, and reduce poverty.

The major result of was a true development round and what was being sold as a development round had very little in common. The development round did not deserve the epithet of *development round*, which would assume that they were living up to the commitments they made. The issue is not simply an issue of agriculture but also of intellectual property, dumping, non-tariff barriers, unskilled and intensive labor services, migration, and escalating tariffs. I could go on, but the point is that there were new issues that should have been placed on the agenda that would promote development, such as the race to the bottom of trying to give tax concessions to attract businesses.

But, as we might expect, the new issues that placed on the agenda were clearly issues of the advanced industrial countries' own interest. One example is government procurement. There are many African countries that are now able to make large sales to the US Defense Department. Even Europe is having trouble, but the US thinks it can make significant inroads in government procurement in developing countries. So, again, is this a development

agenda or is this a US agenda? In the end, it became very clear that these new issues were being raised because it was a US issue and an advanced industrial issue, not a developing country issue.

In the aftermath of the failure in Cancun, the US said it was going to pursue a bilateral strategy, which is even worse than what was happening in Cancun. The good news is that the bilateral strategy has had only very limited success. A few countries, having a very small amount of trade, have been badgered into signing an agreement. Most of that is based on a false hope, a dream that by signing an agreement there would be floods of American firms coming in to do investment. It has not happened; it was just a dream.

What has actually happened can be seen by looking at a couple of examples. The one with the longest history is the North American Free Trade Agreement (NAFTA) with Mexico. After the free trade agreement, growth in Mexico in the last decade has actually been lower than it was earlier, not in the immediately preceding period, but the average of the period 1940 to 1980. It has not been an impressive growth record. What is even more significant, coming back to the theme I mentioned earlier, is that 10 years after NAFTA was signed, real wages in Mexico are lower than they were at the time that it was signed. None of the benefit has gone to the working people of the country of Mexico. Some of the poorest people in Mexico have been made even poorer because subsidized US corn has lowered the price of corn in Mexico. Keep in mind, the poorest people in Mexico are corn farmers, so while some people in the urban areas of Mexico can buy corn more cheaply, the poorest people in the country have seen their income go down.

Little less than a year ago, I was in Morocco during its negotiations with the US over a bilateral trade agreement. It was chosen to have a bilateral trade agreement not for economic reasons—it was not next to the US nor was it a country with a lot of economic synergies. It was simply to show that trade policy could be a basis of good will and that the US could have good economic relations with a moderate Muslim country. With that kind of driving force, you would have thought that the US would be generous in its bargaining, but it was not. The result was that there were street protests in a country that does not normally have street protests. The particular issue that the people focused on—and it is one which should resonate here—is the issue of access to life-saving medicines. After the Uruguay Round, there was widespread agreement that the intellectual property provisions, called TRIPS, were unbalanced. In the US, the Council of Economic Advisors and the Office of Science and Technology Policy opposed it. Though it clearly was a piece of special interest legislation, driven by the pharmaceutical and media industries in the US, that particular view of intellectual property was forced on much of the world.

In the aftermath of the Uruguay round, many people thought that we needed a revision, and that was the spirit of Doha: to go from TRIPS to “TRIPS minus.” But, in fact, the US insistence in Morocco and elsewhere has been on something called “TRIPS plus,” so that access to generic drugs will be more difficult than even in the US. The result of this is that there are estimates of a significant increase of, for instance, AIDS in Morocco, as a result of this bilateral trade agreement. The trade negotiator that I had a chance to talk with in Morocco said that this is not a negotiation: the US tells them and they accept. Sadly, that is the reality—the *realpolitik*—of bilateral trade agreements today.

The same thing is true in other countries. A bilateral trade agreement between the US and Chile included provisions that I find really quite astounding. One of them was that they have restrictions on taxing large cars, even if they are luxury. The reason was obvious: Detroit sells large cars, and it does not want to have their purchase discouraged. Even more surprising was the agreement between Chile and Singapore that says that Chile cannot impose restrictions on capital markets. It has to have full capital market liberalization. Of course, Thailand knows a little bit about the dangers of full capital market liberalization—hot money coming in and out of the country overnight. Chile had capital controls that reduced the amount of money coming into the country in the period before 1997 and thus was able to avoid some of the worst devastations that happened in Argentina when capital flowed out. However, Chile is now not allowed to have even moderate forms of restriction on these capital flows.

What is so striking about this is that even the IMF today recognizes that it made a mistake. Its chief economist and three other authors released a report which pointed out that capital market liberalization did not promote economic growth in many of the developing countries but instead led to more instability. There was absolutely no intellectual foundation for what the US insisted on in its bilateral agreement, and yet it went ahead. When I talked to the President of Chile, he acted as if he was going to be forceful and resist that provision. In the end, however, the dream of a great bilateral trade agreement that would bring an enormous amount of investment and open up the markets was what drove the agreement. I think he soon found out that it was a dream that would not come true. In fact, one of the things that he should have done but did not was to deal with the problem of non-tariff barriers: even after taking away the tariffs, protectionist forces do not disappear. They crop up in other forms, in the form of non-tariff barriers. While the US has stopped imposing non-tariff barriers on Chilean salmon, there was a worry that now, as it gets more successful in exporting wine, the state of California will try to persuade the US government to impose a non-tariff barrier in the form of a dumping duty on wine.

In short, Chile did not succeed in getting a free trade agreement. It got something called a free trade agreement but that was really a *managed* trade agreement. The one positive note to all this is that it has spurred a large number of regional trade agreements: trade agreements among developing countries themselves. These countries are more equal and do not have this imbalance of power, and they have the ability to negotiate something that is truly mutually beneficial.

The third issue I want to talk about is, in some ways, the most serious in the entire world, and that is exchange rate instability. The Dollar-Euro exchange rate has fluctuated enormously. The Euro is now very strong; the dollar is now very weak. This is putting enormous strain on many countries around the world. In the short run, some of the factors are obviously driven, at least in part, by the lack of confidence in the US macro-economy and the large US deficit. There is something hypocritical about the richest country in the world having to borrow close to \$2 billion a day from poorer countries, while at the same time giving lectures to those poor countries about why they should live within their means.

There is a tendency to blame others, and the US is currently trying to blame China. Japan is breathing a sigh of relief. In the early 1980s, when the US had a huge trade and fiscal deficit caused by very similar underlying factors – such as a huge tax cut that the country could not afford - Japan was blamed. Now China is being blamed. It should be clear that the underlying causes of the huge US trade deficit have to do with the US macro-economic

policy. The huge fiscal deficit creates an imbalance between domestic savings and investment, which is made up by borrowing abroad—that is the flip side of the trade deficit. Even if China appreciated its currency, these fundamental macro-economic factors would mean that the deficit would not disappear. It would just shift from the deficit with China to a deficit with some other country. The US deficit problem, therefore, has nothing to do with China's exchange rate. The depreciation of the US dollar is not a zero-sum game: it is not as if the US gains and Europe loses. It is a negative sum game, because while Europe loses, the instability of the exchange rate itself has an enormous cost. The uncertainty discourages investment and leads to an overall weaker global economy. But even more of a concern is the risk for the future. When I say the future, I do not mean the distant future; rather, I mean the next 5 years.

One of my predecessors as Chairman of the Council of Economic Advisors once said that if something is unsustainable, it will not be sustained. The US fiscal and trade deficits are unsustainable, so the question is, what will happen? The answer is, simply: they will not be sustained. A second question, then, is how will this happen? There are 2 possibilities. One is that there could be a crisis, and the other one is that there could be an insidious, ever-growing malaise in which the whole global economy is declining, with things eventually adjusting but at a great cost.

In New York I was talking to a very large currency trader, and he put his bets on a crisis, with the probability greater than 50/50. Some of you may have heard that other investors in the US are also putting their money on the possibility of a crisis. What makes it particularly disturbing is that the US seems to be committed to policies making these deficits larger, not smaller, which puts the global economy at risk. The rhetoric is that we will decrease these deficits, even cut them in half, but it does not explain *how*. You should ask what, exactly, are they going to do? They are going to make tax cuts permanent, adding several trillions dollars, and privatize social security. I said trillion, not billion: these, clearly, are big numbers. The Administration is committed to making the deficit, which is already in excess of 4% of GDP, even larger. If that does not make your digestion bad, I do not know what will.

The next problem, which is actually deeper, is the problem arising in the global reserve system, which makes some of these problems inherent. I do not have time to go into details, but let me highlight some of the contradictions of the global reserve system. It has this hypocrisy, this irony that I mentioned before, that the richest country in the world is borrowing from poor countries. Asia has accumulated an enormous amount of reserves. So, you have countries with low per capita incomes lending to the US at 1-2 % interest rate, and then the US lends a little bit of that money back again with charges from private banks of 15 or 20 %—that is just plain crazy economics! I do not think that can continue as soon as people start realizing what is going on.

There are other problems as well, not only the inherent sense of inequity, but also the problem of instability. The system works as follows: we want countries to hold the dollar in reserves, and, of course, the US is very willing to issue bonds. It is very simple. If you can get goods for somebody based on IOUs, and people keep giving you things, why not continue? Now the question is: as they keep printing these IOUs, and as the US is getting more and more indebted, how does this impact our underlying economic stability? Since the 1980s the US has gone from a huge creditor position to a huge debtor position. Not surprisingly, the debts are mounting, and at some point, people are going to wake up and say, "Do I want to hold all these bonds of this country that is so much indebted?" Some, perhaps many, will answer *no*. Now, you can see where that leads and where it is already leading. As I said, while it may not shift all the way, there is now an alternative reserve currency: the Euro. Countries can now hold their money in

the currency of other countries in their region, so why lend money to the US? Why not lend to some of their neighbors, who have quite strong economies themselves? As they switch reserves from dollars to euros, the value of the dollar is going to decrease. You do not want to be the last country to take your money out of dollars.

To think about this, put yourself in the position of the person managing the reserves of China. China has reserves of something like 700 billion dollars, and it keeps going up. In the last year and a half, the dollar relative to the Euro is down about 25%. If you had bet on putting money in the Euro, China would have in the bank something like 200 billion dollars more. Now, if you believe in accountability, losing 200 billion dollars is a lot of money, especially for relatively poor countries. At some point, somebody is going to ask a question, and the Finance Minister is going to say: how could you possibly lose 200 billion dollars? That is the scenario that leads to the crisis. As country after country starts thinking about this, they pull more money out, making the dollar weaker. Already the private sector has recognized the problem. In the private sector in Europe, there is a net flow of money out of the US. So when you see these numbers, the private money—the smart money—is going out, and, therefore, it is public money that is coming in. The question now becomes: how long could that continue?

There are other problems with the global reserve system. The old system was even more peculiar, when gold was the reserve. People would spend enormous amounts of money in South Africa digging up gold, and then people would spend enormous amounts of money to put the gold back in the ground and bury it. This is a crazy activity. Somebody from Mars looking at the world would see these people digging up money and then putting it back again, and they would think these people have lost their minds. However, that is the old system, and we have moved away from that. Instead, we have a new system, with another peculiar thing: poor countries send their money to America, the richest country. The Martian would think this is peculiar as well. Countries need reserves, because of the huge amount of instability in the world caused by the fluctuation of exchange rates. Thailand and Southeast Asia know about this instability, so it has been natural that they want to have reserves. But what are reserves? Simply put, it is purchasing power that you do not spend, so the global economy is burying in the ground something like 200 to 400 billion dollars a year of pure purchasing power. This is having a huge deflationary impact on the global economy. Things would be worse in some ways if the US was not acting as a consumer of last resort, but if the US stops consuming, the global economy could get even weaker.

There is one more way of seeing this problem, using the basic logic under the current system. Trade deficits in one country equal trade surpluses in another. If you export more than you import, other countries have to import more than you export. Now, if you have some countries in the world like Japan, that insist on having a trade surplus, that means the rest of the world in total has to have a trade deficit. If a country has a trade deficit, like Thailand had before 1997, and all of a sudden gets rid of its trade deficit, the deficit just goes to somebody else. So, trade deficits are like hot potatoes: you wait for a while till it gets too hot, and then you pass the trade deficit on to somebody else, for instance, to the Latin American countries, and, eventually, to Argentina. Without some major reforms, the global economic and financial system will continue to be marked by the kind of instability that we have seen. There will be more crises. We do not know when and in which countries, but it seems that the US is working itself up to be a good candidate for a crisis in the near future. These are fundamental problems, and you will have to read my next book to find the answers.

Let me return to the discussion of the Tsunami. I think one of the lessons that we have learned is that we have to respect the forces of nature. We have to respect the Earth and learn to cope with these underlying forces. There are a lot of discussions about creating an early warning system. No one proposed an international commission to stop earthquakes, because people know that they cannot stop them. Instead, it is a question of dealing with them, managing them. In some areas we already have an early warning, to which we are not responding. For instance, we have ample scientific evidence that climate change is a problem. Even if we did not feel completely sure, we should pause when we think about what we are doing. We are doing an experiment with our planet, where we are increasing the atmospheric concentration of green house gases and will see how high we can get the concentration before we burn up and move on to the next planet. Unfortunately, we do not have that next planet yet, so we are engaging in an experiment from which there is no easy exit.

East Asia has shown that development is possible, and its success has shown that the gap between it and advanced industrialized countries can be narrowed. However, it has not fully answered the question of whether that development can be consistent with environmental demands. Is the world capable of coping with the environmental demands of the scale that success would bring? I think the answer has to be of some concern, for if the rest of the world were successful in even bringing their per capita income close to the level of the US and the Western Europe, the environmental demands on this Earth would not be sustainable. As I said before, if it is not sustainable, it will not be sustained. As a consequence, we may not know exactly what will happen, but the evidence on this I think is overwhelming.

Some think that this is a race between growth and technology, that we should not worry about this problem because technology in 50-75 years will allow us to have standards of living that are much higher with much less resource utilization. Technology will enable us to live with less utilization of natural resources, with better protection of the environment, but it is sheer madness to think that in this race technology will inevitably win, regardless of what we do. In fact, right now there is overwhelming evidence that we are already losing. The President of the US may be powerful, but he cannot repeal the laws of nature, no more than all the wishes of Finance Ministers and Treasury Secretaries can repeal the laws of economics. We must learn to cope with these laws and understand them. Only by doing so will we be able to deal with the impending threats to the global economic order. Thank you.

Q&A session:

Question 1: Mr. Pongsan Pantulab: Chair of Doctoral Program, Ramkhamhang University: You mentioned in evaluating economic change that those in positions of political power played an important role in shaping the evolution of society and technology in times of great crises like the Asian Tsunami catastrophe. What would you propose to Asian leaders in order to mollify the Asian disaster? Secondly, paradigm shift appears ubiquitous in the international society. What kind of new paradigms would you suggest on a global scale in order to minimize the conflicts of interests between the developing and advanced industrial economies in addition to stimulate the welfare enhancing and the quality of life for all?

Answer 1: Let me make a remark on the second question: I think there is a fundamental difference between the way citizens traditionally have looked within their country and the way they look at things internationally. Within one's country, one talks about social justice, fairness, equity, and helping the poor. Internationally, in the past,

economic relations have really been driven more by views of real politics and power. All these principles of equity got thrown out the window, and people think only of their own interests. This is beginning to change, for a number of reasons. First, there is a growing civil society sector that tries to articulate concerns about international social justice. People care about suffering across borders, and you see that with the recent tsunami. Disasters always bring out the most charitable feelings in people. The rhetoric, at least, in many countries lately is the notion that there should be the principle of foreign assistance. If you do a survey, even in the US, people believe there ought to be more foreign assistance to developing countries.

The good news is that there has been a broadening of the notion of social justice beyond borders. If you take an area like trade policy, there is actually an enormous amount of coincidences rather than conflicts of interest. If we really have a successful democracy, it would be in the interest of the US to get rid of agricultural subsidies, which distort the price of, for instance, cotton. There are only 25,000 cotton farmers in the US who receive subsidies that affect the livelihoods of millions of cotton farmers in developing countries. In a way, the issue is not a conflict between developing and developed countries but instead is a reflection of the imperfections of democracy in the advanced industrial countries. In some sense, a huge part of the paradigm shift is the recognition of trying to figure out the source of the problem.

The third reason why I actually have some optimism is that, as globalization has progressed, interdependence has increased, and with the increase of interdependence there is an increase in awareness of the need for collective action and of the dangers of unilateralism. The alternative to unilateralism is the rule of law, and the principles of the rule of law should be principles of equity and fairness, in which developing countries will get better outcomes than, for instance, in the Uruguay Round. The fact that, after Cancun, we have a regime in which the developing countries can stand up to the developed countries and say that they will not go on is a success for the developing world. Before that, when I talked to US trade representatives, they would often say to me that they know our corn subsidies are outrageous and there is no intellectual defense but that their hands are tied by our Congress. What am I to do, they said, we have a democracy. However, what happened in Cancun was that the developing countries came back and said, we have a democracy and our hands are tied, too. Their citizens said that if they come back from Cancun with another agreement as unfair as the last one they signed, they are out of office. We have a democracy that says we insist on an agreement that is in the interest of a few special interests, and that is unfair.

In terms of the first question, as I said in the beginning of my talk, I think the response in the region to the tsunami has been extremely impressive. In fact, the nature of a crisis is that it does not happen everyday, so you do not have a rule book to work by. When I think of all the things people thought through and have done, I have been very impressed with how well things have gone.

Question 2: Ms. Jantawan from the Bank of Thailand: I was inspired by your analogy of a large country that one day finds itself losing US\$200 billion because of the exchange rate movements. I was wondering what would be your advice to small developing countries in such a scenario?

Answer 2: Reserve policy has an element of politics as well as economics. It is interesting that you asked about a small country as opposed to a large country, because China is in a very different position from Thailand. If

China tries to change its reserves into Euro, the value of the dollar would go down so much that it would take a loss on its other holdings. In a sense, countries that have huge holdings, such as China and Japan, are in a bind. Smaller countries have a lot more freedom in their actions. One of the things that you learn very early on when you are in the Government is not to predict interest rates, stock markets, and exchange rates. I will probably violate that in this talk. In my own judgment there is a significant enough risk of a dollar going down that, as Putin would say, at least you would want to have a diversified portfolio, with a significant fraction in other currencies.

I want to come back to the fact that Asia ought to try to change the global reserve system, partly as a political action, to say, why should we in Asia be lending money to rich countries, to Europe and the US? Instead, why don't we lend to each other? You help each other and get a diversified effect. Reserves are like a cooperative agreement. If I am in trouble, here is a claim for resources that can help me out in that trouble. That is what a reserve is. Your reserves should not be highly correlated with your own economy, because you should not hold your reserves in a currency that moves down with yours when a crisis occurs. However, the region is now sufficiently diversified that a significant fraction of the portfolio ought to be held within the region itself.

Question 3: Is there any good news?

Answer: There is a little bit of a silver lining in the cloud that I have just described. The debate on globalization itself has changed enormously in the last 5 years. Five years ago, for instance, when the Seattle riots and protests occurred, a lot of people were startled. People did not understand how unfair the previous trade agreements had been. The problems with capital market liberalization were not understood. Everyone thought to blame the victims, that it was Southeast Asia's own problems. However, there has been a tremendous change in understanding, and the one silver lining, especially from the Iraq war, is the recognition of the dangers of unilateralism. There is now a real understanding of the need for global collective action and for the UN.

Just to give you an example: in September, at the meeting of the UN, the presidents from Spain, France, Brazil, and Chile gave a presentation on innovative mechanisms for financing global public goods. The resonance of that was huge. Over a hundred countries came to the presentation and signed on to that idea. No one expected that statement from a huge number of countries, that now is the time in which there is a need for more cooperative action. You see that again in the response to the Tsunami disaster here in the region, so I think that is the good news. It does not solve all the problems, but at least it is the beginning of the solution.