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Commentary

BUFFIN PARTNERS INC. ECONOMIC INVESTMENT AND ACTUARIAL RESEARCH

Strategies for Global Economic Recovery

The current global economic and financial crisis presents many opportunities for economists to develop strategic initiatives that are designed to stimulate economic activity and accelerate the recovery process. The International Monetary Fund (IMF) has developed specific proposals and action plans for this purpose. The global economy is in a severe recession with a serious financial crisis and loss of confidence. According to the IMF, the rate of economic contraction should moderate in the second half of this year with world output projected to decline by 1.3 percent for 2009. IMF projects recovery in 2010, with the global economy growing by 1.9 percent for the year. To assist with this recovery, policies have been implemented involving the use of public capital and the creation of liquidity, together with monetary easing and fiscal stimulus packages. Financial market stabilization will take some time to accomplish. However, it is expected to improve as greater clarity is achieved concerning losses and impaired assets. Infusions of new capital will ameliorate insolvency concerns, reduce counterparty risks and dampen market volatility. The effect will be to improve liquidity and achieve stability. However, the economic outlook remains difficult and uncertain. It will require strategic initiatives in both the macroeconomic and financial policy arenas. Policy choices will require international cooperation. Strategic economic policy initiatives should focus on supporting international financial flows and stimulating global trade; they should also be sensitive to the concerns of financial and trade partners in the global economic community.

The first policy priority at present is financial sector restructuring. This will enhance the prospects for economic recovery and improve the environment for other initiatives to take effect, including monetary policy and fiscal stimulus. The three essential components of this policy initiative are improving access to liquidity, managing distressed assets, and recapitalizing weakened financial institutions. Critical to this initiative is the need to develop and implement a realistic system of loss recognition for impaired assets. This will necessitate global standards and common basic methodologies for the valuation of securitized credit instruments based on expected economic conditions and rational assessments of future income streams. Regulatory reforms are also essential in the financial sector. Regulatory authorities need to establish appropriate levels of capital for financial institutions and for future unexpected losses. Viable banks with insufficient capital need to be recapitalized as a matter of priority, with capital provided by governments and/or private capital sources. Capital ratios need to be increased to a more robust level in order to regain market confidence.

A second priority is to implement monetary easing to counter deflation risks. Although interest rates have effectively been reduced to zero in some countries, many other countries have not adopted this strategy. A policy of lower interest rates may need to be supplemented by other measures such as utilizing central banks' own balance sheets to support credit intermediation. Central banks in emerging economies will need to exercise caution with policy initiatives so as to maintain credit ratings, provide continuing incentives for capital inflows, and avoid disruption of market financing and disorder in currency exchange rates.

Of longer-term concern is the challenge of how to manage the timing of the exit strategy from these extraordinary policy initiatives. The timing needs careful management to avoid acting too soon before the economic recovery has become viable and sustainable, whereas there is a great danger that maintaining these policies in effect for too long will create an inflationary environment that is characterized by the emergence of further asset price bubbles. To steer a course between providing short-term economic stimulation and achieving long-term stability and sustainability, it is desirable to target measures that bring long-term benefits to the global economy. Infrastructure investment can play an important role to help achieve this objective. The Organisation for Economic Co-operation and Development (OECD) has promoted infrastructure investment as a critical issue to achieve economic and social development. Infrastructure systems (such as transport, communications, water and electricity supply, port facilities and roads) contribute to economic prosperity and growth, as well as enhancing the well-being, health and safety of populations and the quality of the environment. Technological progress, industrialization, urbanization, migration, population growth, health issues and demographic factors (such as ageing populations), climate change and resource depletion, all create needs for new infrastructure development and investment. The OECD has addressed these issues and has made a number of policy recommendations related to infrastructure investment. The list of OECD recommendations includes: public-private partnerships; investment by institutional investors including pension funds; levying user charges for funding infrastructure; expanding traditional revenue-raising sources; funding by land value capture; modifying legal and regulatory framework to encourage new sources of capital and innovative business models; improving reliability of infrastructure functioning; strengthening framework for standards; and exploring ways and means to provide more effective financing and delivery of infrastructure projects.

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