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## **Macroeconomic Stability and Financial Regulation: Key Issues for the G20**

### **New e-book analyzes a range of reform proposals ahead of the London Summit**

The current crisis is not only systemic, but global: it involves the advanced countries, emerging market countries, and poor countries. There is no decoupling, and solutions must involve reciprocal commitments and actions. The G20 process and the London Summit offer the prospect of concrete, implementable results that can restore confidence and lead the way to recovery.

For this reason, CEPR joined the Reinventing Bretton Woods Committee in organizing a seminar with the G20 Deputies on 31 January, hosted by HM Treasury and the Bank of England and involving academics and private sector participants as well as the officials.

A new e-book *Macroeconomic Stability and Financial Regulation: Key Issues for the G20* brings together the papers presented at this seminar. Edited by **Mathias Dewatripont, Xavier Freixas** and **Richard Portes**, it analyzes a range of policy proposals:

- Address global imbalances by creating *credible insurance mechanisms* for countries that forego reserve accumulation and stimulate domestic expansion; and by accelerating the development of financial systems in emerging markets, in particular local currency bond markets and foreign currency hedging instruments.
- Use macroeconomic policy to meet any threat of deflation *promptly*, with a *zero interest rate policy and quantitative easing*, and an inflation target to avoid expectations of deflation.
- Design fiscal stimuli cooperatively, so that they *internalise the effective demand externalities of the stimulus while reflecting each country's 'fiscal spare capacity'*.
- *Mitigate procyclicality* by adjusting the Basel II capital requirements using a multiplier based on macroeconomic conditions.
- Create a *centralized clearing counterparty for CDS trades without further delay*. Consider requiring that CDS be exchange-traded and prohibiting naked CDS.
- Sever the link between credit rating agencies (CRAs) and issuers, so that a CRA's rating cannot be influenced by the prospect of future business with the issuer. Prohibit indirect payments by issuers to CRAs in the form of the purchase of consulting or pre-rating services.
- Consider eliminating the 'hard wiring' of the CRAs in the regulatory system – less rather than more regulation here.
- Force greater disclosure of information about the underlying pool of securities for structured instruments.
- Establish a *harmonized bankruptcy regime for banks*, based on US-style 'prompt corrective action', giving the supervisor strong powers over bank managers and shareholders before the bank is technically insolvent.
- Consider the creation of an *International Financial Stability Fund* that takes equity positions in the financial institutions of participating countries and monitors their activities.

While these are for the most part either 'micro' or 'macro' proposals, the editors stress above all the short-run policy imperative. Here the two are deeply complementary. *Neither monetary nor fiscal policies will work unless and until the blockages in the supply of credit are resolved.* Financial intermediation and the structure supporting it must be restored to near-normal conditions to stop the accelerating decline.



**Centre for Economic Policy Research**

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The book is available to download free of charge at [www.VoxEU.org](http://www.VoxEU.org)

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