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# The Next Bretton Woods

***by Joseph E. Stiglitz***

NEW YORK – The world is sinking into a major global slowdown, likely to be the worst in a quarter-century, perhaps since the Great Depression. This crisis was "made in America," in more than one sense.

America exported its toxic mortgages around the world, in the form of asset-backed securities. America exported its deregulatory free market philosophy, which even its high priest, Alan Greenspan, now admits was a mistake. America exported its culture of corporate irresponsibility – non-transparent stock options, which encourage the bad accounting that has played a role in this debacle, just as it did in the Enron and Worldcom scandals a few years ago. And, finally, America has exported its economic downturn.

The Bush administration has finally come around to doing what every economist urged it to do: put more equity into the banks. But, as always, the devil is in the details, and United States Treasury Secretary Henry Paulson may have succeeded in subverting even this good idea; he seems to have figured out how to recapitalize the banks in such a way that it may not result in resumption of lending, which would bode poorly for the economy.

Most importantly, the terms that Paulson got for the capital provided to America's banks were far worse than those obtained by British Prime Minister Gordon Brown (not to mention those that Warren Buffett got for putting far less into America's soundest investment bank, Goldman Sachs). Share prices show that investors believe that they got a really good deal.

One reason to be concerned about the bad deal that American taxpayers are getting is the looming national debt. Even before this financial crisis, America's national debt was scheduled to increase from $5.7 trillion in 2001 to more than $9 trillion this year. This year's deficit will approach a half-trillion dollars; next year's will be even larger, as the US downturn steepens. America needs a big stimulus package. But Wall Street's fiscal conservatives (yes, the same people who brought us this downturn) will now be calling for deficit moderation (reminiscent of Andrew Mellon in the Great Depression.)

Now the crisis has spread, predictably, to emerging markets and less developed countries. Remarkable as it may seem, America, for all its problems, is still seen as the safest place to put one's money. No surprise, I suppose, because, despite everything, a US government guarantee has more credibility than a guarantee from a third-world country.

As America sops up the world's savings to address its problems, as risk premiums soar, as global income, trade, and commodity prices fall, developing countries will face hard times. Some – those with large trade deficits *before* the crisis hit, those with large national debts that must be rolled over, and those with close trade links to the US – are likely to suffer more than others. Those countries that did not fully liberalize their capital and financial markets, such as China, will be thankful that they did not follow the urging of Paulson and the US Treasury to do so.

Many are already turning to the International Monetary Fund for help. The worry is that, at least in some cases, the IMF will go back to its old failed recipes: fiscal and monetary contraction, which would only increase global inequities. While developed countries engage in stabilizing countercyclical policies, developing countries would be forced into destabilizing policies, driving away capital when they need it most.

Ten years ago, at the time of Asia's financial crisis, there was much discussion of the need to reform the global financial architecture. Little – too little, it is now evident – was done. At the time, many thought that such lofty appeals were a deliberate attempt to forestall real reform: those who had done well under the old system knew that the crisis would pass, and with it, so too would the demand for reform. We cannot let that happen again.

We may be at a new "Bretton Woods" moment. The old institutions have recognized the need for reform, but they have been moving at glacial speed. They did nothing to prevent the current crisis; and there is concern about their effectiveness in responding to it now that it has hit.

It took the world 15 years and a world war to come together to address the weaknesses in the global financial system that contributed to the Great Depression. It is to be hoped that it will not take us that long this time: given the level of global interdependence, the costs would simply be too high.

But, whereas the US and Great Britain dominated the old Bretton Woods, today's global landscape is markedly different. Likewise, the old Bretton Woods institutions came to be defined by a set of economic doctrines that has now been shown to fail not only in developing countries, but even in capitalism's heartland. The forthcoming global summit must face these new realities if it is to work effectively toward creating a more stable and a more equitable global financial system.

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