EXTRAORDINARY TIMES DEMAND EXTRAORDINARY ACTION

LONDON SCHOOL OF ECONOMICS

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THE HON WAYNE SWAN MP, TREASURER

Good morning.

It is a great pleasure to be here with you all today.

I want to thank the LSE for its invitation to address what is truly one of the world's great educational institutions.

It is an institution that has fostered some of the world's leading economic thinkers, such as Sir John Hicks, Friedrich Hayek, James Meade and Robert Mundell – and my personal favourite, James Hacker, MP.

I am sure that Professor Davies followed that reference, but I am not so sure about the younger members of the audience.

The contributions of these scholars have been both theoretical and practical from a policy perspective.

Your graduates are working in the finance industry the world over, to restore the fortunes of tottering banks, to revive ailing financial markets.

They are working in central banks and finance ministries to stimulate failing economies and clean up fragile financial systems.

They are advising world leaders on how to get out of this mess.

As always, economists have a variety of different views, but it is only through open and vigorous argument that we are most likely to arrive at the correct response and to head off avoidable future difficulty.

Dealing with the crisis is what particularly concerns me on this visit to London.

As you may be aware, I am here to meet with my fellow G-20 Finance Ministers.

The G-20 includes the members of the G-7, the biggest advanced economies.

But it recognises that there are now other and increasingly important elements in the global economy not represented by the G-7.

It includes emerging markets, which have been among the most dynamic agents of globalisation in recent years, as well as developing economies.

All of the world's regions are represented.

The G-20 is playing such a critical role in delivering a global response to what is truly a global crisis.

NATURE OF THE GLOBAL PROBLEM

The LSE's motto is "to understand the causes of things".

I will proceed in that spirit, by defining the nature of the global problem, before detailing the Rudd Government's menu of responses and solutions.

Now, I do not need to underline for you – situated as you are a few underground stops west of the city – how challenging the circumstances of the global economy now are.

The city is one of the epicentres of this financial earthquake.

The financial market difficulties that were so magnified by the collapse of Lehman Brothers seven months ago have intensified, and are increasingly being complicated by the resulting slump in cross border trade, output, employment, investment and confidence.

An insidious negative feedback loop has developed, where declining economic activity has put further stress on financial systems.

This places yet more pressure on the balance sheets of financial institutions – and yet more strain on the ingenuity, endurance and strength of purpose of central banks and finance ministries as they seek to arrest the slide.

Financial firms worldwide have already recorded more than US$1.1 trillion in losses and write-downs since the crisis began

And that number will probably go higher still.

Wealth destruction has proceeded on an undreamt scale.

Global stock prices have fallen by around US$32 trillion in value as a result of the crisis (or by more than half) – the worst result since the days of silent movies.

And spreads on US investment grade corporate bonds – a reasonable proxy for broader stresses in global credit markets – have reached the highest levels since June 1932.

Outright financial distress has brought about the biggest slump in the global economy in living memory.

It is now clear that the public sector, acting in coordinated fashion through forums such as the G-20, must provide a break in the circuit.

The major advanced economies are officially in recession – including the United States, United Kingdom, the Euro area and Japan.

Growth in the key emerging economies of China and India — the engine room of the global economy over recent years — has slowed dramatically.

In East Asia exports and industrial production have tumbled.

Some of Australia’s regional neighbours have seen output fall more sharply than it did during the Asian Financial Crisis 12 years ago.

As a result of these global developments we have seen forecasts for global growth revised down on almost a weekly basis.

And just earlier this week we had the sobering assessment from the World Bank that the global economy was likely to shrink for the first time since World War II and world trade could suffer its biggest fall in 80 years.

The gravity of this global economic crisis has evoked dramatic policy responses from governments around the world.

Governments, including my own, have increased spending aggressively to offset some of the decline in private spending.

Governments, including my own, have announced bank funding guarantees to stabilise financial systems.

And in some other cases governments have been forced to provide liquidity, capital and solvency support to major financial institutions, in some instances to the point of full or partial public ownership.

Central banks have also taken unprecedented action to support private inter-bank markets as they seek to maintain credit growth and private spending.

Your own Bank of England has cut official interest rates to their lowest level since the bank was created in 1694, and has announced a bold program to expand the monetary base and buy public and private debt.

The US Federal Reserve has lowered rates effectively to zero and is expanding its balance sheet very aggressively.

Without these domestic policy actions, financial and economic conditions would be even worse – no question about it.

There is clearly a great deal more to do.

But the global nature of this crisis also demands broader international cooperation as well as domestic action.

This crisis began with rising delinquencies in the US sub-prime mortgage market infecting the collateralised debt obligations into which so many sub-prime assets had been aggregated.

The CDOs became untradeable, their values impossible to ascertain.

Eighteen months later the problem of these toxic assets is still with us – still weighing on fragile financial institutions which can't sell (or even sensibly value) the assets, and which must make increasing provision against the very real risk of losses.

And with the downturn in economic activity, with the predictable impact on jobs, the stock of impaired conventional assets is rising daily.

In these circumstances the global financial system can't work, and the global economy can't work.

It is as simple, as stark, as that.

Impaired assets are constraining the ability of banks to lend.

Most of the measures to deal with this toxic debt must of course be taken by national governments.

But it is also important to develop an international framework so governments are encouraged to deal with the problem consistently and to minimise unintended negative consequences.

The financial institutions involved are, after all, mostly operating across many borders, and the problem they pose is global as well as national.

There are other aspects, too, in which this crisis has an international as well as a national dimension.

International financial institutions such as the World Bank and the IMF have a crucial role to play in mitigating spillovers to the world's developing economies.

The contraction in global trade and capital flows associated with this crisis is having a dramatic impact on many of the emerging economies.

The World Bank estimates that developing countries face a financing gap of up to US$700 billion.

And, of course, the crisis has highlighted the need for urgent and wide-ranging reform of the global financial regulatory system.

That is why, in our response to this crisis, the Prime Minister Kevin Rudd and I have not only been active at home, but have also engaged extensively in the global response.

Australia's major banks have not suffered substantial exposures to toxic assets and they have remained profitable and highly rated.

As for public bailouts of failing banks, there have been none.

As our financial system is sound, adequately capitalised and well regulated, that is what one would expect.

But because we live in an integrated world, Australia is suffering from the problems in the financial systems of some of the major economies.

This is why we have been very active in seeking international cooperation in addressing the problem of impaired assets in American and European banks – because we will all benefit.

You may interpret this as enlightened self-interest if you like.

I will return to our international priorities later but let me first sketch out briefly how Australia has fared during this global crisis.

STRENGTH OF THE AUSTRALIAN ECONOMY

The global crisis has posed immense challenges for us, as a trading nation with an open economy.

Despite strong fundamentals, against the backdrop of the sharpest synchronised global downturn for many years, no economy in the world can hope to escape unscathed.

The global recession means that demand for our exports has fallen and commodity prices have fallen sharply.

We learned recently that Australian output contracted in the fourth quarter of last year as it did in most advanced economies and in much of East Asia, though the downturn in Australia was very much less than elsewhere.

However the Australian situation is much better than most.

We've been hit hard but I think I can say that battered as we have been, we are still upright, still battling, still faring better than almost all other developed economies.

We have many strengths.

Our financial system is in good shape.

Our financial regulatory framework works well, as you would perhaps expect, given our chief prudential regulator earned his doctorate here!

Our banks are well capitalised and profitable.

Indeed each of Australia's four largest banks are rated AA, putting them among just 11 institutions globally.

Australia has not suffered the acute financial stresses that many other countries have experienced.

The economy is flexible and adaptable, the result of decades of reform.

The central bank has cut the cash rate further and faster, and to a lower level than in living memory.

Our government budget position is much stronger than that of comparable countries.

Even with the large expected falls in revenues and extra spending in our stimulus packages, we currently estimate the Australian Government's net debt will be only a little over 5 per cent of GDP by 2011-12.

This compares with an average net government debt of OECD countries of about 45 per cent of GDP.

Our strong government balance sheet position gives Australia the flexibility to temporarily take up some of the slack from the weak private sector without running up excessive debt and without moving outside of our medium-term fiscal framework.

Challenged by this global slump, the Australian Government has acted promptly to offset some of the worst effects of the global financial crisis.

We have adopted a comprehensive approach – to support our financial system, to support jobs, to support spending, to help get us through.

We have announced major stimulus packages to help support the economy in these difficult times, including the $10.4 billion Economic Security Strategy and the $42 billion Nation Building and Jobs Plan.

As the IMF has suggested, our programs follow the rule of being timely, targeted and temporary.

The scope and speed of our fiscal packages have been an Australian success story.

Without those packages I have no doubt whatsoever that demand would be weaker and unemployment higher.

We judged that the risk of doing too little and doing it too slowly were too high – too high in terms of jobs lost, of output lost, of life opportunities for younger Australians lost.

But we have also laid out a clear plan to return the Budget to surplus and therefore reduce debt over time.

We have clear exit strategies in place for our responses to the crisis, linking short-term policy action with medium-term reform goals.

We plan to come out of this crisis with an economy that is stronger, more resilient, and more productive than before.

The Government has reaffirmed its commitment to achieve budget surpluses, on average, over the economic cycle.

As the economy recovers, and grows above trend, the Government will take action to return the Budget to surplus.

Another part of the Government's policy response to the global financial crisis is to continue to push ahead with our ambitious reform agenda to ensure that we emerge from this crisis stronger, more resilient and more productive.

That is why around 70 per cent of our recent fiscal package is focused on initiatives to build prosperity for the future.

It includes investment in our schools, in housing, and in improving regional links to the national highway network.

We are training Australians in large numbers, so that when we spring into recovery our people can take the maximum benefit.

For those people who, through no fault of their own, are unable to gain or retain work during the economic slowdown, the Government is investing in a range of measures to help them improve their skills.

We have also moved to support our financial system, in the face of the global financial crisis.

Our actions have been designed to keep our financial system strong, while maintaining credit markets functioning.

In October last year the Rudd Government moved like other countries to guarantee bank deposits and wholesale funding.

The guarantees have ensured our financial system remains strong and able to raise substantial funds in global markets – as the Reserve Bank Governor clearly acknowledged a few weeks ago.

Australian banks have been able to raise around half of the current year's funding needs in just the past two months.

And they are on track to issue 10 per cent of global guaranteed issuance, the third biggest issuer of guaranteed bank paper behind France and the US.

This goes to the high regard with which both our banks and the government guarantee are held in global markets.

IMPORTANCE OF GLOBAL ACTION

The current economic crisis is truly global in its proportions.

National government actions to restore demand and stabilise financial institutions are an essential part of restoring growth and prosperity.

But because it is a global crisis it will also need coordinated global action to address both the causes and the consequences of this crisis.

It is in every G-20 nation's interest to influence and be part of that response.

Australia wants to advance international responses to the current crisis.

Our Prime Minister Kevin Rudd and I were leading proponents of the idea to hold a Summit of G-20 Leaders in Washington DC last year to develop a coordinated global response to the current crisis.

The G-20 has already delivered through the Leaders' commitment to - and subsequent delivery of - coordinated fiscal stimulus.

It has also set out a clear path for financial sector regulatory reform.

Much significant work has been done and is underway.

But there is even more that needs to be done.

Since the leaders met in Washington in November we have seen the true extent of the global recession that is unfolding.

This just underscores the importance of the meeting of G-20 Finance Ministers this weekend, which in turn paves the way for the Leaders' meeting at the beginning of April.

As the grouping representing 85 per cent of the global economy, the London Summit must help advance government actions to deal with the current economic crisis.

We must maintain progress on implementation of the Action Plan set out in the Washington Declaration to undertake fundamental reform of the global financial system.

Because if we don't address the root causes of the crisis, we cannot ensure this does not happen again.

In the lead-up to the London Leaders' Summit, we have emphasised the need for governments to continue programs for dealing with toxic assets, maintaining the impetus for fiscal stimulus measures and resisting trade and financial protectionism.

Let me take some time here and outline the importance of each of these priority areas that Australia will be pursuing at this weekend's meeting and to prepare for the Leaders' meeting in London.

Toxic Assets

The first priority is addressing the problem of toxic assets that infect global bank balance sheets.

This vital issue has been firmly put on the agenda by Prime Minister Rudd as a challenge that must be embraced if we are to restore confidence and growth in the global economy.

Restoring normal credit flows is vital to economic recovery and the success of fiscal stimulus measures announced to date.

To this end we must strive for agreement on an international framework for dealing with toxic or "legacy" assets.

An international framework on toxic asset management would establish clear elements and principles for international cooperation – recognising that individual countries may adopt different approaches that reflect different national circumstances.

Development of this framework could be assisted by the IMF and international standard-setting bodies such as the Financial Stability Forum.

Fiscal Stimulus

Fiscal stimulus is also a key priority for these meetings.

Last year, the IMF estimated that the world economy required a fiscal stimulus of at least 2 per cent in 2009.

While many countries have undertaken significant action, it is clear that global economic conditions have deteriorated and more is required from countries that have the capacity to take further action.

The London Summit provides an opportunity for leaders of G-20 member countries to signal – where appropriate - their commitment to further fiscal stimulus.

These commitments must be accompanied by matching commitments to restore fiscal balance once growth has been restored.

This is necessary to maintain confidence in sovereign bond markets.

Recent movements in the cost of insuring against sovereign debt default highlight the importance of this principle.

IMF Reform

IMF reform is a third priority.

Australia is co-chair (with South Africa) of the G-20 working group on Reform of the IMF.

In that role we want to see a number outcomes from the London Summit on IMF reform:

To begin with, a commitment by G-20 members for at least a doubling of the Fund’s pre-crisis resources.

This will primarily have to be through bilateral borrowing from members in the short-term.

And in this regard we welcome the recent agreement by Japan to lend US$100 billion to the Fund.

We also want to secure the IMF’s resources over the medium- to long-term.

That’s why we want to immediately start the process for the expansion of, and a significant increase in, the New Arrangement to Borrow (NAB), as well as accelerating the next review of quotas to be concluded by January 2011.

We are also calling for the early ratification of the Fourth Amendment to the Fund’s Articles which will see a once-off allocation of SDRs and will boost the foreign exchange reserves of some of the countries hardest hit by the crisis.

-- We also need to enhance the IMF’s lending instruments.

In particular we want to see the establishment of an effective, high access, precautionary crisis prevention instrument.

We believe a further streamlining in conditionality and an increase in the Fund’s capacity to assist low-income countries are necessary.

We want to accelerate the redistribution of quotas in line with country’s changing weights in the world economy.

This redistribution, which should enhance the voice and representation of emerging markets and developing economies, should be completed by January 2011.

And we need to see faster governance reforms in the institution, including restructuring the Executive Board and facilitating greater ministerial involvement in the operations of the Fund.

Finally, we want to see the IMF, working closely with the Financial Stability Forum, play a stronger surveillance role in identifying future risks to global financial stability.

Countering Protectionism

The fourth set of goals we've identified revolve around countering protectionism.

Trade is the mechanism through which growth and prosperity are transmitted between countries.

Every day billions of dollars of goods and services are bought and sold around the world, giving consumers access to new products and generating wealth and jobs.

But the crisis we now face has thrown this process into reverse.

World trade flows are falling, forcing businesses to close and threatening the livelihood of millions of the world's poor.

Protectionism undermines efforts to restore capital flows and stimulate economic growth.

That's why we are determined to see a robust commitment against not only *trade* protectionism, but also *financial* protectionism at the London Summit.

CONCLUSION

We appreciate this is an ambitious agenda.

But we also know extraordinary times demand extraordinary responses.

There is little doubt that 2009 will be a tough year for the global economy.

It will be a tough year for the Australian economy.

Australia is however faring better than almost all of our peers in the developed world.

That is in no small part due to the pre-emptive actions taken by the Rudd Government to cushion Australia from the worst effects of this global economic and financial crisis.

But we know that we are not immune from global developments.

There is only so much that any one country can do to resist the pull of the global recession.

This is a global problem requiring global responses.

The Australian Government has been playing a key role in finding international solutions to the current crisis, because its ramifications are being felt by every Australian.

In this interconnected world, we know we are all in this together.

Bold, decisive and globally coordinated actions are necessary to stabilise financial markets and put the global economy on the path to recovery.

Thank you.