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Shocks to system show need for fresh answers

*di Alistair Darling**

It was John Maynard Keynes who said that "the difficulty lies not so much in developing new ideas as in escaping from the old ones". In recent months, economies have faced challenges of unprecedented proportions. They need exceptional solutions.

The confluence of the worst financial crisis for generations and the surge in commodity prices has hit every country – the result of fundamental changes in the world economy. These twin shocks demonstrate the need for new, comprehensive approaches to maintain stability, both in economies and financial markets. For just as no government on its own can combat global terrorism or tackle climate change, so no government alone can put in place the right safeguards to secure the benefits of economic integration.

How we collaborate to meet these challenges is the focus of this weekend's meetings in Washington. We should keep two goals in sight. The immediate priority has to be stability. We will discuss how events that started in financial markets now seem to be feeding through to the real economy. All forecasters, including the International Monetary Fund, have been surprised by the profound impact of this shock. Beyond that, it is clear that the global financial system will never be the same, so we must discuss how to strengthen the system for the future.

The first challenge is to ensure that we each take the appropriate action to prevent financial collapse and minimise the impact of the global downturn across the world economy. This requires a comprehensive approach that restores confidence in the system, puts banks on a stronger footing and supports the real economy over the short and medium term. Markets cannot do this alone. Governments have to take the necessary action to enhance and maintain stability in the banking system. That is why I announced specific and wide-ranging measures this week to strengthen capital and enhance liquidity, covering three areas.

First, in conjunction with the Bank of England, we have acted to provide sufficient short-term liquidity. Second, I have made new capital available to UK banks and building societies, putting them on a stronger footing. Third, to ensure banks are willing to start lending to one another again with confidence, I offered a temporary government guarantee for new debt.

The global nature of these problems means it is important for all countries to adopt a comprehensive approach, recognising that different national circumstances will require different specific solutions. In the US, I welcome Hank Paulson's troubled asset relief programme. At the meeting of European Union finance ministers this week, we agreed to work together to rebuild confidence in the banking system. This included the need to apply flexibility in EU state aid decisions and to apply the EU stability and growth pact in a way that reflects exceptional circumstances. But more action will be needed. I shall be discussing with other finance ministers how we can further build on these approaches.

We will also take forward in Washington our work to strengthen international supervision, based on improved co-operation between national supervisors. Last April finance ministers agreed to implement recommendations on strengthening regulation and we have made good progress on these issues, including disclosure. But the turmoil has underscored the need for further, speedier action, including on reviewing capital requirements, executive compensation structures that encourage irresponsible risk-taking, the finance system's procyclicality and improving cross-border co-operation.

Delegates at Bretton Woods in 1944 created the IMF to promote a stable monetary system. It is clear, however, that the postwar institutions have not kept pace. Over the past decade, systemic vulnerabilities and imbalances in the global financial system emerged against the backdrop of

increasingly integrated markets and enormous capital flows, low inflation and low interest rates. This encouraged financial institutions to seek higher returns and develop increasingly complex products.
We need to shift the IMF's focus towards surveillance of the links between the financial sector and the real economy. It will identify risks in advance, co-operate with the Financial Stability Forum to design policy and regulatory responses and strengthen links between ministers, in the Group of Seven and beyond, to ensure effective follow-up. The world economy is changing. Sticking with the solutions of the past is not an option. Now, more than ever, we need new ideas.

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