

# Kaushik Basu on “Globalization and the art of designing policy”

## Summary of the 20<sup>th</sup> Global Economy Lecture

Compiled by  
Julia Wörz

The 2015 Global Economy Lecture<sup>1</sup> was delivered by *Kaushik Basu*, Chief Economist and Senior Vice President of the World Bank. In his presentation at the OeNB on November 16, 2015, he illustrated how globalization influences national economic policies and how economic events in one country can have repercussions in other countries, which may then feed back into the country of origin again. As an example he mentioned the downgrade of the United States’ credit rating by Standard & Poor’s on August 5, 2011. Contrary to expectations and to textbook economic theory, this led to a strong demand for U.S. T-bills as Chinese investors were aiming at preventing losses on their sizable U.S. dollar holdings, which in turn created depreciation pressure on the Indian rupee. More generally, he emphasized the discrepancy between national policy needs and the potential global effects of national policies and argued in favor of so-called “reasoned intuition.” In his view, policymakers need to take into account the effects of their national policies abroad and to factor in foreign policy and market reactions when designing their policies. He also pointed toward multiple equilibria which emerge in case of self-fulfilling prophecies and herding behavior. Using the example of credit markets, Basu illustrated that a small change in price signals (i.e. an interest rate rise) may induce a large and sudden fall in credit supply if the economy moves from a high-credit equilibrium to a low-credit equilibrium.

Turning to the euro area, which Basu called the biggest globalization experiment in history, he observed that the flaws in the construction of the euro area were not apparent initially and became evident only through the global economic crisis, when borrowing costs within the euro area suddenly started to diverge. In his view, the impossibility of sharing the public debt burden in the euro area is one of the factors hampering the smooth functioning of credit markets in the euro area and is thus an issue that needs to be revisited. In the remainder of his talk, he focused on emerging economies. He identified the following policy needs in a globalized world: better global economic governance through institutions like the G-20, the IMF and the BIS; strategic thinking in constructing domestic policies that takes into account foreign policy reactions; openness to new ideas.

In the discussion he recalled that trust is an important element for the functioning of societies. However, in a globalized world, we need regulation to guide economies toward the desired behavior. Regulation can also help to rule out multiple (and undesired) equilibria. Finally, he compared the euro area to India, where many different states share a common currency and emphasized that one economy needs one currency. Although today’s world is becoming a global economy, he does not consider all countries, and especially not all emerging economies, to be ready for sharing a world currency.

<sup>1</sup> *The Global Economy Lecture is an annual event organized jointly by the Oesterreichische Nationalbank (OeNB) and The Vienna Institute for International Economic Studies (wiiw).*