

Viewpoints

February 2009

This article was originally published in the [Financial Times on February 16, 2009](#).

Active Governments Must Work Together

By Mohamed El-Erian
February 16, 2009

I am mesmerised, concerned and hopeful by the surge in policy activism around the world. It is fascinating to see governments forced into even more unconventional policy responses.

Anxiety comes from the growing risk of collateral damage, including a new “beggar thy neighbour” phenomenon which threatens the longer-term growth and poverty alleviation potential of the global economy. Yet, as this becomes obvious, there is hope we may finally see a meaningful effort at global co-ordination.

After initial hesitations, most policymakers are now willing to do “whatever it takes” to counter today’s global crisis. Yet willingness does not equate with effectiveness. Despite bold measures, policymakers are yet to trigger badly needed “circuit breakers.” As a result, the crisis continues to morph into an even greater menace for global growth, employment and welfare.

What began in 2006 as a turn in housing has evolved into the simultaneous and disorderly collapse of three other huge sectors: global finance, industrial country consumption, and demand in emerging economies. Even the strongest are contaminated. Witness how profitable firms shed labour, the rich cut spending, and cash-rich investors retreat to the sidelines.

Understandably, policymakers are scrambling to provide an offsetting balance sheet and bypass damaged institutions. It is no longer a question of whether we will see additional fiscal stimulus packages around the world; it is how large and how fast. Governments are also in the business of bailing out “national champions,” however controversially defined. And central banks are opening new financing windows for non-banks while also helping to rehabilitate a crippled banking system.

This policy activism, while necessary, is a violent departure from the past 25 years. It is led by countries that, not so long ago, lectured others on limiting the government’s role. Yet, the shift is tolerated, if not supported across the political spectrum – understandably so as the alternative of cascading market failures is more costly and socially unacceptable.

In some cases, policy measures are made up on the fly and without the help of a master plan that imposes the internal consistency needed in such a radical shift in policy regimes. As such, we are far removed from the world of “first best”. That is why policy effectiveness has been less than complete.

Viewpoints

February 2009

Looking forward, there are two factors that suggest a high risk of additional collateral damage and limited effectiveness in the months ahead. First, it is not clear government balance sheets can carry the burden imposed on them.

Mushrooming government financing needs must be covered at a time when many holders of debt are turning from buyers to sellers. No wonder the Federal Reserve is “prepared” to buy Treasury bonds. But will the world be comfortable with two US public agencies offsetting operations that ultimately must be supported by someone else?

Second, virtually every country now seeks to implement fiscal stimulus and rescue national champions. Yet those with weak initial conditions will find it difficult to keep up. Instead they face a lose-lose proposition: maintain the pace of policy activism and lose control over funding costs and, in some cases, exchange rates; or abandon it and see the economy hollowed out by the actions of others.

Fortunately, such clouds have a silver lining. As the risks become clearer, a greater degree of international policy co-ordination may emerge. This is not just about regulatory harmonisation. It is also about the urgent need for policy principles that limit the risk of this new type of beggar-thy-neighbour phenomenon. Otherwise, the policy activism of some countries will undermine those of others and, by implication, the welfare of the global economy.

The US is best placed to lead the effort. It should take advantage of its special relationship and team up with the UK which, as host of the upcoming G-20 meeting, can forge an international consensus for macroeconomic policy principles. Delay will complicate an already dangerous global crisis of no winners; just differences in the extent of loss.

The writer, chief executive officer and co-chief investment officer of PIMCO, is author of [“When Markets Collide: Investment Strategies for an Era of Global Economic Change”](#) (McGraw Hill), the 2008 FT/Goldman Sachs business book of the year.

Singapore¹

PIMCO Asia Pte Ltd
501 Orchard Road #08-03
Wheelock Place
Singapore 238880
65-6491-8000
Registration No. 199804652K

Hong Kong²

PIMCO Asia Limited
24th Floor
Units 2403 & 2405
Nine Queen's Road Central
Hong Kong
852-3650-7700

Viewpoints

February 2009

¹ Regulated by the Monetary Authority of Singapore as a holder of a capital markets services license for fund management, and an exempt financial adviser. The services and products provided by PIMCO Asia Pte Ltd are available only to accredited investors, expert investors and institutional investors as defined in the Securities and Futures Act. The investment management services and products are not available to persons where provision of such services and products is unauthorized.

² Licensed by the Securities and Futures Commission for Types 1, 4 and 9 regulated activities under the Securities and Futures Ordinance ("SFO"). The services and products provided by PIMCO Asia Limited are available only to professional investors as defined in the SFO. The asset management services and investment products are not available to persons where provision of such services and products is unauthorized.

Past performance is not a guarantee or reliable indicator of future results. Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk.

This material contains the opinions of the author but not necessarily those of the PIMCO Group and such opinions are subject to change without notice. This material has been distributed for informational purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Statements concerning financial market trends are based on current market conditions, which will fluctuate. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. This material was reprinted with permission of Financial Times 2009. Date of original publication February 16, 2009.