Implications of the G20 Leaders Summit for Low Income Countries and the Global Economy

Testimony to the House Financial Services Subcommittee on International Monetary Policy and Trade

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Thank you for the opportunity to testify to this Subcommittee. Representing the G24, I am particularly grateful given the importance of the topic for the emerging markets and the developing countries of the world.

Although the crisis originated in mature markets, and although emerging markets and developing countries were not directly exposed to the toxic assets that have affected financial institutions in many advanced countries, the crisis is having a deep and in many ways disproportionate impact on developing countries through various channels including sharply contracting exports, declining remittances, falling prices of commodity prices and a massive withdrawal of private capital flows. A few emerging markets have been severely hit by the global credit crunch, but most emerging markets and developing countries have been able to withstand the immediate financial aftershocks of this crisis. Indeed the relative calm in emerging markets has been a positive and sharply contrasting feature compared to the past. The cost to developing countries instead has come in the form of sharp declines in growth, rising unemployment—possibly by as much as 50 million in 2009—and increases in poverty and deprivation. Moreover it is likely that developing countries will see longer lasting effects and remain more vulnerable in the face of a further or more protracted downturn.

Despite significant improvements in policies across the developing world and the build-up of better cushions over the past decade, most developing countries do not have the leeway to withstand severe liquidity pressures or undertake the kind of countercyclical measures that the G20 agreed was needed as part of the collective response to the crisis. In recognition of the constraints faced by emerging markets and developing countries, the G20 leaders committed to a range of measures to bolster the international financial institutions so that they could greatly expand their support to emerging markets and developing countries. These proposed measures were more ambitious in some respects than others, but their overall thrust was laudable and the immediate challenge is turning the commitments made into concrete and expeditious actions.

Before I elaborate on the specific areas where action is now needed, let me underline four reasons why support for emerging markets and developing countries at this juncture is in the global collective interest and in the interest of the United States. First, support from the international financial institutions and especially the IMF can help ensure that the crisis is contained, and that there are no further adverse threats to the restoration of confidence at an extremely fragile and uncertain time for the global economy. Second, it is important to keep in mind that emerging markets and developing countries accounted for more than 75 percent of global growth and almost 50 percent of the increase in import demand before the crisis. Economic recovery in these countries is therefore critical to global growth and to the growth of US exports that in turn must be a bulwark for US recovery. Third, we cannot forget about the plight of the poorest countries not just because of the moral imperative but because how important economic and social progress in these countries is to peace and security all over the world. And, finally, the financing that the G20 is proposing to mobilize and channel through the international financial institutions does not for the most part entail a major burden on the tax payers of the developed world. Most of the financing would be precautionary or in the form of loans, and not requiring large fiscal outlays in the advanced countries including the US.

In terms of the specific actions proposed by the G20, the most ambitious is the trebling in the resources of the IMF initially through a significant expansion in the New Arrangements to Borrow. Since the outset of the crisis the IMF has committed more than \$147 billion in GRA financing, including precautionary financing, to 20 countries which is almost 60 percent of the IMF's available resources excluding the Japanese bilateral loan. Given that many other countries are in active discussions with the IMF on financing arrangements and given the large downside risks that still remain in the global economy, an early agreement and implementation of a new and more flexible New Arrangements to Borrow is absolutely critical for not only emerging markets but for global financial stability. Such an agreement must, however, be seen as only a bridge to a permanent increase in the IMF's resources through a general quota increase which in turn must be linked to a realignment of quotas away from Europe to emerging markets and the developing world. We welcome the clear position that the US has expressed in this regard, and would urge that this position continue to be stressed in whatever arrangements are agreed upon. We also believe that it will be important to implement the IMF's new lending and conditionality framework in an evenhanded way, recognizing in particular the exogenous nature of the crisis. We also believe that a new SDR allocation of \$250 billion will help boost liquidity and reserves at a time when both are much needed, especially for the more vulnerable as well as the poorest countries.

While the IMF is the firewall against immediate and potential liquidity threats, the World Bank and the regional development banks have a critical role to play in this crisis in meeting financing needs across a wide array of countries in supporting countercyclical policies including for social safety nets, sustaining investments including for infrastructure, trade finance and bank recapitalization. Given the scale of these financing needs, and given the magnitude of the withdrawal in private finance, the proposed increases in MDB financing, of around \$100 billion over the next two years, appears if anything quite modest. Bolstering the capital of the World Bank, including IFC, and of the regional development banks is therefore critical not only in ensuring that they can respond adequately to the crisis but that they can provide the long-term development financing needed in the aftermath of the crisis and the financing needed for global public goods including the looming challenge of climate change. We believe that it is absolutely imperative that this major expansion in the role of the multilateral development banks go hand in hand with improvements in their policies and governance. But this does not mean yet new conditions imposed by the Bank or the shareholders of the North, either as conditions for capital increases or in the way the Banks do business. The aim must be to place accountability for results and good governance squarely with the countries and their governments, and to rely much more on country systems and ex post reviews and sanctions.

Finally, let me close by noting that the aspect in which the G20 was perhaps able to produce the least ambitious results was on the support for the poorest countries. Although the poorest countries were not hit as visibly by the financial market spillovers, the ultimate impact of the shocks is more adverse given their limited capacity to withstand the shocks. The crisis has resulted in a financing shortfall in the range of $35-$50 billion for the poorest countries. At the London Summit, the G20 committed to use additional resources from agreed gold sales and any other surplus income to provide $6 billion in additional concessional resources from the IMF over the next 2 to 3 years. The use of gold sales remains contentious but the key is the political commitment to augment the concessional resources of the IMF. Even more important is the need to augment and bring forward the replenishment of the concessional arms of the multilateral development banks, especially IDA. A frontloading of IDA resources alone will simply not produce the scale or certitude of concessional resources that is needed. In the scale of the numbers that are now being expended, the amounts of resources that we are talking about for the poorest countries are extremely modest. At a time when many poor countries had begun to lay the foundations for sustained growth and make more meaningful headway on poverty and other development goals, it would be a real tragedy if the poorest countries fell through the global safety net.

Let me end on a note of optimism. Even though many would have liked to have seen even bolder actions out of the London Summit, the G20 raised the bar on the response to the crisis and the role that the international institutions can play in a way that few would have considered feasible even a few weeks before the crisis. But those commitments will remain hollow unless there is determined follow through in governments and legislatures across the world. The leadership of the US, and of the US Congress, in the timely and ambitious implementation of commitments can pave the way for a new era of international cooperation and for reinvigorating the legitimacy and effectiveness of the international financial institutions at a challenging time for us all.

Thank you.