



BRIEFING NOTE
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THE LONDON G-20 SUMMIT: The Global New Deal We Need

by Neil Watkins¹

SUMMARY

The current financial crisis is set to dramatically increase poverty in the developing world: the World Bank projects that 53 million people may be pushed into poverty in 2009. As G-20 leaders prepare to gather in London on April 2 for a major economic summit, they must place the impacts of the global crisis on the world's poor firmly on their agenda. Leaders should respond with bold new commitments to address the impacts of the crisis and reduce global poverty.

As they respond, they should act justly and avoid repeating mistakes of the past. That nearly all the proposals put forward by G-20 leaders call for significant increases in the capital and role of the International Monetary Fund (IMF) when developing countries have spurned their advice in recent years is cause for concern. The G-20 should give greater consideration to regional initiatives and alternate global institutional structures when crafting a response to the current crisis. Additionally:

- **Developing nations must be allowed to use fiscal stimulus**, just like rich nations.
- **Assistance to low-income countries should be provided in the form of grants rather than loans.**
- **Funds should be provided with critical safeguards to ensure transparency, accountability, and safeguards for human rights and the environment.**
- Leaders should consider **expanded debt cancellation** as part of their response. Debt cancellation could be financed by the sale of IMF gold above and beyond the amount the IMF has proposed to sell to finance its internal operations.

BACKGROUND: THE GLOBAL CRISIS AND THE LONDON SUMMIT

On April 2, President Barack Obama will travel to London to meet with the leaders of the world's largest economies. The goal of the gathering is to develop a coordinated response to the global financial crisis. Among the top agenda items will be coordinating stimulus plans to put the world economy back on track and restarting lending by banks.

It is also critical that leaders take the opportunity of their gathering to respond to the devastating impacts of the economic crisis in the developing world. The World Bank predicts that the crisis will cause 53 million people in developing countries to fall below the \$2 a day income level this year. This comes on top of the 130-155 million pushed into poverty in 2008 by soaring food and

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fuel prices.² It is hard to imagine significant progress towards achieving the Millennium Development Goals (MDGs) under these circumstances.

A number of proposals have been put forward by UK Prime Minister Gordon Brown, the summit's host, including a call for a "Global New Deal" for developing countries. Such calls are a welcome recognition of the urgency to address the impact of the crisis on the world's poor.

Brown proclaimed in mid-February, "We need a global new deal, we need a grand bargain between the countries and continents of the world so that the world economy can not only recover but the economic system of the future can be based on the soundest and best principles of all. We decided that the international institutions should have at least \$500 billion, to enable them not just to deal with crises, but to enable them to be able to prevent crises."³

The US and other wealthy nations have a moral obligation to alleviate the devastating impact of the crisis on the world's poorest countries, especially since the crisis was caused by policy failures in the developed world.

Nancy Birdsall of the Center for Global Development has estimated that in order to respond to the crisis G-20 leaders would need to make available \$1 trillion in new resources from the international financial institutions.⁴ It's clear a Global New Deal is urgently needed. The question is how to ensure such an agreement is just and avoids the pitfalls of the past.

TOWARD A GLOBAL NEW DEAL?

The international community must respond with bold new commitments to address the current crisis. The US and other wealthy nations have a moral obligation to alleviate the devastating impact of the crisis on the world's poorest countries, especially since this crisis was largely caused by policy failures in the developed world. Support and finance from public institutions is needed to replace private flows which are rapidly drying up.

But as an organization that has long worked on issues of international debt, development policy, and the policies of international financial institutions in the developing world, Jubilee is urging a bold response that does not repeat the policy failures of the past.

International Financial Institutions: From Famine to Feast ?

To put the proposed \$500 billion - \$1 trillion in new IFI resources into context, it is important to remember that the IMF lent \$1.5 billion in their last fiscal year and the World Bank just over \$24 billion. Just a year ago, developing countries were turning away from the World Bank and IMF and their controversial policy advice and the IMF was struggling to prove its relevance. Even in the current difficult economic environment, only one country in Latin America that finished IMF

² Reuters, "FACTBOX - Financial crisis and world's poor, February 26, 2009.

³ Nicholas Watt and Jill Treanor, "IMF emergency fund is doubled to \$500bn in global rescue effort," *The Guardian*, February 23, 2009.

⁴ Nancy Birdsall, "How to Unlock the \$1 Trillion that Developing Countries Urgently Need to Cope with the Crisis," Center for Global Development *Notes*, February 2009.

programs turned back to the Fund -- El Salvador. Only one country in Asia did so, Pakistan, after exhausting all possible alternatives.

This reflects an underlying view in many developing countries that went through the Fund experience that they do not think traditional Fund policies are good for them. The enormous new investment and mandate that has been proposed will dramatically expand the power of these institutions and massively increase their lending when many developing countries are skeptical

Think Globally, Act Regionally

In their rush to the international financial institutions, G-20 leaders risk ignoring regional alternatives that could ultimately help create a more balanced and just global economy. In Latin America, the Bank of the South could be strengthened and could play a role in insulating Latin America from global economic shocks. During the Asian Financial crisis of the late 1990s, there was serious talk about the development of an Asian Monetary Fund until the US scuttled the idea. Last week, however, ASEAN together with Japan, China and South Korea agreed to form a \$120 billion pool of foreign-exchange reserves that can be used by countries to defend their currencies from the fallout of the global financial crisis.⁵

As regional alternatives emerge, it is important that they not be dismissed or opposed by the US and other G-20 nations. A response that involves a multiplicity of actors has greater potential to avoid the failed “one-size-fits-all” approaches favored by the World Bank and the IMF in past crises.

In the end, G-20 proposals will likely involve significant increases in the resources and mandate of the international financial institutions. If such an increase in responsibility and power is agreed, it should be tied to strong requirements for reforms at the IMF, commitments to increased grant financing for low-income countries, strengthened safeguards on lending, and a commitment to expanded debt relief financed by IMF gold sales.

STIMULUS FOR THE SOUTH TOO: NO DOUBLE STANDARDS AT THE IMF

There is almost unanimous support among economists, G-20 leaders, and leaders of the IMF and World Bank of the need for stimulative economic policies, including deficit spending and low interest rates to spur consumer activity and help the world economy to recover.

As IMF Managing Director Dominique Strauss-Khan said in early February 2009: “For a year now, since I spoke at Davos last January, the Fund has advocated fiscal stimulus to restore global growth. There is now a broad consensus on this.”⁶

⁵ Shamim Adam and Suttinee Yuvejwattana, “Asean Vows to Cut Tariffs as Recession Batters Regional Economy,” Bloomberg, March 1, 2009.

⁶ International Monetary Fund, “Statement by the IMF Managing Director Dominique Strauss-Kahn at the Conclusion of his Visit to Malaysia,” Press Release No. 09/29, February 7, 2009.

Likewise the UN Commission on the global financial crisis, chaired by former World Bank chief economist Joseph Stiglitz recently urged that crisis response funds “be provided without the usual conditionalities, especially those that force these countries to pursue pro-cyclical policies or to adopt the kinds of monetary and regulatory policies which contributed to the current crisis.”

These are the types of policies that made up the New Deal and helped the United States escape the Great Depression. These same policies are now part of the US’ and other rich nations’ response to the current economic downturn. It would be reasonable to expect any policies the IMF promotes in the context of a “Global New Deal” to be similar in nature.

But a closer look reveals a glaring double standard between IMF rhetoric and the policy advice it dispenses with its current crisis lending. In its crisis loan to Serbia in January, the IMF advised “...there is no scope now for countercyclical fiscal loosening. Anything less than a tight fiscal stance could also jeopardize the credibility of the program in the eyes of foreign investors and the Serbian public. Fiscal policy will in addition need to put a tight constraint on nominal wage growth in government sectors and public enterprises.”⁷

Unfortunately Serbia’s case is not unique:

- In its January 2009 loan to El Salvador, the IMF required tax increases and cuts in gas and transport subsidies to meet its deficit target;
- In its December 2008 loan to Latvia, the IMF required an immediate 15 per cent reduction in government employees’ wages, a 30 per cent cut in nominal spending on wages from 2008 to 2009, a cut in government spending equivalent to 4.5% of GDP, a pension freeze, and a value-added tax increase⁸;
- In its November 2008 loan to Hungary, the IMF required reduced government expenditure on public sector wages, pensions, and social benefits in order to reduce the deficit from 3.4% to 2.5% of GDP.⁹

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Instead of the current IMF policies, developing nations could be encouraged to initiate fiscal stimulus policies of at least 3% of GDP, and more if they face cuts in foreign assistance.

The IMF must support the same stimulative policies in developing countries as they do in developed ones. Why should El Salvador, Hungary, or Latvia be constrained from pursuing similar policies to the ones the US and other rich countries have implemented in response to the crisis? While there is clearly a need to avoid huge new debt burdens, stimulus at the level of 3%

⁷ Analysis by Bhumika Muchhala, Third World Network, citing International Monetary Fund, “Republic of Serbia: Request for Stand-by Arrangement,” January 23, 2009.

⁸ As reported in Bretton Woods Project Update No. 64, January/February 2009, citing official IMF loan documents.

⁹ See Bhumika Muchhala, “IMF Loans in Response to the Financial Crisis (September 2008-January 2009),” Third World Network Global Finance program, February 2009, analysis of official loan documents.

of GDP should not cause concerns – especially if that’s what it takes to get economies growing again. For low-income countries, grant finance or debt cancellation could help provide some of the additional financing.

GRANTS ARE MUCH BETTER THAN LOANS

Proposals advanced by some G-20 leaders and prominent advocates could create upwards of \$1 trillion in new public debt for the developing world – on top of the \$2.7 trillion owed by developing nations. This is addition to the fact that the cost of borrowing for developing countries on private capital markets has grown significantly in recent months, further adding to debt levels.

As G-20 leaders consider committing additional funds to help respond to the crisis, as much of it as possible should be made in the form of grants, especially for low-income countries. Countries eligible for the Heavily Indebted Poor Countries (HIPC) Initiative have made significant progress in recent years in reducing their external debt burdens. It would be dispiriting if this progress were lost due to a lack of political will to provide new grant-based assistance to low-income countries to help respond to the crisis, and these countries are forced into taking on new loans.

Moreover, some analysts are urging that World Bank funds for low-income countries could be made available much more quickly – Homi Kharas of Brookings, for instance, argues that up to \$60 billion in aid money is already in the pipeline, of which \$33 billion is at the World Bank (International Development Association) – and these funds can be advanced or re-allocated.¹⁰ Especially because IDA assistance has a significant grant element and around half of IDA assistance provided in the form of actual grants, this is a welcome suggestion.

G-20 leaders could also commit to an early, advanced replenishment of the International Development Association (IDA) to ensure grant-based finance for development. IDA assistance must, however, be reformed so that grants are not provided with harmful economic conditions as they have in the past.

PRESERVE SAFEGUARDS AND ADOPT RESPONSIBLE LENDING STANDARDS

While there is no doubt that developing countries need help urgently, a balance must be struck between disbursing loans quickly and ensuring transparency, accountability, and safeguards for human rights and the environment. If loans are quickly prepared without due diligence and safeguard policies, the crisis could result in a huge new burden of odious and illegitimate debt in developing countries.

Johannes F. Linn, Executive Director of the Wolfensohn Center for Development at the Brookings Institution, urges the Bank to declare a “development emergency” and under these conditions, “the Bank’s fiduciary and safeguards procedures should be put under emergency rules.”¹¹ Nancy Birdsall urges the G20 to call for “a temporary emergency suspension of

¹⁰ Homi Kharas, “The Financial Crisis, a Development Emergency, and the Need for Aid.” Brookings Paper, February 11, 2009.

¹¹ Johannes F. Linn, “World Bank Reform: Proposals for the Next G-20 Summit,” Brookings Paper, February 25, 2009.

concentration ratios, internal limits...and relaxation of the usual procurement, environment, and other safeguards that delay World Bank and other multilateral bank disbursements for as much as two years.”¹²

Safeguard policies and environmental standards should not be relaxed or abolished. Non-governmental advocates in the South and the North have fought for more than two decades to win accountability and environmental safeguard policies at the World Bank. If anything, such policies need to be strengthened, so that old destructive mistakes are not repeated. Now is the time for the World Bank to adopt strong standards for responsible lending, such as those laid out in the European Network on Debt and Development’s (EURODAD) Charter on Responsible Financing. These standards would help to ensure that loan terms and conditions are fair, that the loan contraction process is transparent, that human rights and the environment of recipient nations are respected and that repayment difficulties or disputes are resolved fairly and efficiently.¹³ The banking sector has been offered loans on flexible and changing terms – but new loans from the IMF/World Bank have no provisions for dispute resolution.

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While we need to find fast and ideally concessional or grant-based financing for crisis response, without proper safeguards and a new responsible lending framework, funds aimed at resolving a crisis could create a new crisis of odious or illegitimate debt.

DROP THE DEBT: IMF GOLD SALES FOR EXPANDED DEBT CANCELLATION

Absent from proposals to date has been a call for expanded debt cancellation as a way to help poor countries. Debt relief is a proven, effective, and fast-disbursing way to deliver support. In essence it is budget support with built in safeguards to ensure transparency, accountability, and human rights. Why aren’t we seeing any official proposals for expanded debt relief to help meet the MDGs in this time of crisis?

It’s in the nature of international financial institutions (IFIs) to make new loans rather than relieve debt. The purpose of a bank – even public banks like the IMF and World Bank – is to make loans, to collect interest and (if possible) to grow. The World Bank and IMF provided debt relief to 24 impoverished countries under the Multilateral Debt Relief Initiative (MDRI), but only after having been forced into it by massive political pressure. The IFI’s do not like debt relief for this basic reason despite acknowledging its efficiency as a form of aid.

The other obstacles to expanded debt cancellation are questions about the costs to taxpayers in the developed countries. In the current restrictive economic climate, will the US, Europe, and other donors have funds to compensate the World Bank or the IMF for a huge expansion of poor country debt relief? The US is actually falling behind on its debt relief commitments to fund the MDRI and has growing arrears to the World Bank.

¹² Birdsall 2009, op cit.

¹³ Eurodad Charter on Responsible Financing, February 6, 2008, available at www.eurodad.org

This is why funds from the sale of IMF gold must be tapped to expand low-income country debt relief and get the MDGs back on track. Last April, the IMF's board approved a proposal to sell a portion (403.3 metric tons) of its vast gold reserves to help fund its administrative budget. In light of the unfolding global crisis, this proposal could be revised to reflect the new global reality and level of need. As the global financial crisis pushes millions into poverty across the globe, the IMF can help by expanding its gold sales proposal to help finance anti-poverty efforts. The IMF's gold is a global public good, comprised of contributions from the IMF's member countries over a period of many years. The money should be treated as the shared global resource it is.

IMF gold sales can fund expanded low-income country debt relief and help get the MDGs back on track.

The best way to do this is to sell an additional amount of IMF gold equivalent to the IMF's original proposal and to use the proceeds of this additional gold sale to create a Debt and MDG trust fund. Additional gold sales can be accomplished utilizing the plan laid out in the IMF's current gold sales proposal without affecting the market price of gold. The debt and MDG trust fund should be used to help cover the arrears of countries to the IFIs as they become eligible for debt relief and to help expand debt relief to additional low-income countries.¹⁴

Debt campaigners have long advocated for gold sales to finance debt cancellation. The price of gold is at one of the highest levels of all time and the IMF itself has produced a detailed report on the viability of gold sales.¹⁵ Indeed, with gold being almost the only commodity whose price is shooting up and projected to keep going up, this may not be so much of a concern anymore. It is time to move forward with this proposal now that, concerns over the impact of such a move on the price of gold and IMF resistance over the possibility of losing some of its financial strength have been overcome.

RECOMMENDATIONS

As G-20 leaders prepare to gather in London on April 2, they must place the impacts of the global crisis on the world's poor firmly on their agenda. Leaders should respond with bold new commitments to address the impacts of the crisis and reduce global poverty. As they respond boldly, they must do so *justly* and avoid repeating mistakes of the past.

- **Developing nations must be allowed to use fiscal stimulus**, just like rich nations.
- **Assistance to low-income countries should be provided in the form of grants rather than loans.**

¹⁴ The Jubilee Act, a bill which passed the US House in April 2008 and nearly passed the Senate, would expand debt relief to up to 24 additional low income countries beyond those already eligible. President Obama and Vice President Biden were original co-sponsors of this legislation in the last session of Congress.

¹⁵ See forthcoming Jubilee USA Policy Brief, "IMF Gold Sales in the Context of Global Financial Crisis: A Proposal for Gold Sales for Debt Relief," March 2009.

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- Leaders should consider **expanded debt cancellation** as part of their response. Debt cancellation could be financed by the sale of IMF gold above and beyond the amount the IMF has proposed for sale to finance its internal operations.