

network of regional reserve funds –a system akin to the European Central Bank or the Federal Reserve System. A similar design could serve for prudential policies and for the international debt court.

The developing countries are in an excellent position to contribute to this task, given their large foreign exchange reserves. Using those reserves more actively for swaps among central banks, pooling them in reserve funds, or using them to

support the development of regional bond markets will multiply their room to manoeuvre. These reserves and existing sovereign wealth funds could create or capitalize MDBs and be invested in bonds issued by such institutions. The multiplication of sub-regional and inter-regional development banks owned by developing countries is one of the most fertile grounds for South-South cooperation.

Global Crisis in Need of Global Solutions

Kevin P. Gallagher¹

*Global Development and Environment Institute,
Boston University*

Bear Sterns, Fannie Mae, Freddie Mac, Chrysler, General Motors, and Citigroup have all been called “too big to fail.” Indeed, the story goes, their collapse would cause “systemic risk” to the economy. To avoid such risks, developed and large developing nations are spending trillions of dollars on stimulus plans.

According to the United Nations Commodity Trade Statistics, the developing world now comprises more than 47 percent of the world’s \$55 trillion economy and is the destination for more than half of all OECD country exports. The developing world is also home for the 3 billion people on the planet living on less than \$2.50 cents per day.

The developing world is too big to fail. If they fail the rich countries will not recover. The Obama administration should be making that case to the US public and to the world as it prepares for the G-20 summit in London next month.

Although the G-20 issued a call for a coordinated global response to the crisis, the poorer nations are receiving very little attention. The most desperate nations have sought the International Monetary Fund (IMF), which has been applying a double standard when it comes to responding to the crisis.

Various surveys of stimulus plans find that the majority of G-20 countries have put together some sort of stimulus package, amounting to roughly \$ 2-3 trillion². By definition, all of these plans are expansionary (increase spending to stimulate demand) in nature.

With the exception of most Latin America countries, the majority of these plans originate in the developed or large developing countries. The US plan of \$787 billion consists largely of tax cuts, support

for infrastructure, with some funding for health care and green energy. China’s plan of \$586 billion (much larger than the US plan in terms of GDP) goes into infrastructure, disaster protection, and programs for automakers, ship builders, and electronics factories.

Many nations will be going into heavier debt to finance these stimulus packages. The United States has been running notorious budget and current account deficits of over three and four percent of GDP respectively for the past five years. Japan holds a budget deficit of five percent of GDP but will spend \$110 billion on a package that amounts to 2.3 percent of GDP. India’s relatively smaller stimulus package of \$4 billion will be conducted in an era where India has a budget deficit of 6 percent of GDP and a current account balance of almost four percent.

Latin America was one of the few regions in the world that created stabilization funds during the commodities boom. According to the United Nations Economic Commission for Latin America and the Caribbean, nations of that region have embarked on a host of smaller but significant stimulus packages, in addition to bank bailouts, and efforts to save their currencies³. Chile’s stabilization fund is the most well known. That country has \$1.5 billion in public spending to stimulate demand. Bolivia’s public investment rose by 20 percent to 1.9 billion and will be spent on infrastructure projects.

No country is safe, however. Despite Latin America’s valiant efforts the Economist magazine put Mexico, Brazil, Argentina, and Venezuela among the most likely to fall. These countries either have a high amount of short-term debt as a percent of their total reserves and/or their bank loans as a percent of total deposits are at a risky level⁴.

Pakistan, Latvia, Ukraine, Hungary, and

¹ This brief article has been adapted from his recent column on the same subject in the Guardian: <http://www.guardian.co.uk/commentis-free/cifamerica/2009/mar/02/us-economy-development>
² Stimulus plans: http://www.loc.gov/law/help/financial_stimulus_plan.php;

³ Link to CEPAL Study: http://www.cepal.org/noticias/noticias/1/34991/2009-16-The_reaction_of_LAC_governments_WEB.pdf

⁴ Source: “Domino theory” Feb 26th 2009, The Economist print edition: http://www.economist.com/finance/displaystory.cfm?story_id=13184631

Iceland, have already had to seek refuge in the IMF. Others are approaching their door. Since the rich countries set policy at the IMF, one might think that

the IMF's policies would mimic the broad stimuli of the rich countries, right? Think again.

IMF Plans to Developing Countries

Country	Amount (US\$)	Percent of GDP	Conditions
Pakistan	7.6	5%	Increase interest rates Cut energy subsidies Reducing fiscal deficit to a more manageable 4.2 percent in 2008/09 and 3.3 percent in 2009/10 State Bank Of Pakistan (SBP) will act on monetary policy to build its international reserves, bring down inflation to 6 percent in 2010. SBP to eliminate central bank financing of the government. Increase in expenditure on the social safety net through cash payment and electricity subsidies
Latvia	2.35	6%	maintain a pegged exchange rate (to the Euro). Latvia has agreed to keep its budget deficit down in 2009 to below 5.0 percent of GDP and to bring it up to 3.0 percent of GDP in 2011. immediate 15% reduction in local government employees' wages 30% cut in nominal spending on wages from 2008 to 2009 cut in government spending (equal to 4.5% of GDP) pension freeze and value-added tax increase
Ukraine	16.4	5%	inflation targeting - 17% (2008 inflation was 30%) Reduce budget deficit to 1% of GDP from 2% in 2007 Increase social spending with .8% of GDP, increase energy tariffs

Source: Gallagher, Kevin P., et al, *Survey of Stimulus and IMF Rescue Plans during the Global Financial Crisis: I*, February, 2009 (www.bu.edu/ir/faculty/misc/Survey.xls)

Even though the G-20 called for counter-cyclical approaches (cut spending when times are good, increase during the crisis) to the crisis, our survey finds that the IMF is pushing contractionary policy (cut spending) on the recipients of their loans. While the rich countries lower interest rates to zero and spend trillions of dollars to recover (even when that means going into ever more debt) Pakistan is being forced to cut fiscal spending and raise interest rates. Latvia is being forced to cut spending and slash wages. Ukraine is allowed to increase social spending but has to reduce its budget and inflict inflation targeting. All three of these countries dominate news headlines because their governments are extremely fragile and vulnerable. IMF conditionality may be the hair that breaks the camels back in each instance.

If the response isn't global we will also push more of the poor off the cliff. We used to be able to boast that since 1999 the world brought over 200 million people over the poverty line of \$2.50 per day. The World Bank's most recent estimates show that up to 53 million people fall below that poverty line if the crisis persists. The Bank had already reported

that 73 to 105 million had been pushed into poverty from the food crisis that has shaken the world over the past few years⁵. Given that the food crisis was in part caused by the same global imbalances of savings and spending that triggered the financial crisis, the food and financial crises could erase practically all the gains in poverty alleviation achieved over the past ten years.

As world leaders convene in April for the G-20 summit on the global financial crisis they should commit to a global stimulus package that includes the world's poorest countries and reforms the International Monetary Fund's hypocritical conditionalities as it serves its function as a lender of last resort.

The Centre for Global Development conservatively estimates that the developing world needs at least \$ 1trillion to cope with the crisis. When the Obama administration goes to the next G-20 summit next month it should leverage at least that much for the poor. This would in part be financed by an increase by \$250 billion of the IMF's Special Drawing Rights. Another \$100 billion would come from the Multi-lateral development banks, and the

5 World Bank study: <http://www.worldbank.org/html/extdr/financialcrisis/>

rest would come in the form as commitments from developed countries through their own stimulus program⁶.

If the developing countries aren't part of a comprehensive global response to the crisis we will all be worse off. Rich country stimulus plans have been too focused on their domestic multiplier effects rather than global ones. At the very least, if the developing countries do not grow, where will our exports go?

As the multilateral financial institutions step in to help, they must halt their draconian conditionalities and become more accountable to the countries they serve. Developed countries have learned that counter cyclical fiscal policies are the appropriate response to the crisis. In every case developed and large developing countries are increasing spending on both the production and consumption end of the economic spectrum. At the same time, the richest of these countries who control the IMF are insisting

that the developing world embark on contractionary policy or lose the privilege of the IMF coming in as a lender of last resort. The IMF should do as members of its executive board do: pursue expansionary fiscal (and monetary) policy to get out of a crisis, tighten up when the economy is back on its feet. To ensure this, the IMF should be democratized to include the developing world. The global economy, and the world's poor will depend on it.

⁶ Center for Global Development study: <http://www.cgdev.org/content/general/detail/1421143/>