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The World Economic and Financial Crisis:
Next Steps for G-20 Cooperation

The worst of the contraction in world output and employment is yet to come. Financial turmoil may well continue. Government cooperation to mitigate the effects of the crisis and to avoid beggar-thy-neighbor policies is badly needed. The meeting of G-20 heads of state in London on April 2nd is a crucial opportunity for leaders to agree on actions that will combat the crisis.

Failing to cooperate could weaken confidence further and worsen the crisis. The disaster of the 1933 London World Economic Conference, occurring at a similar time of worldwide economic distress, is a reminder of the damaging effects that can occur if leaders fail to act cooperatively.

The needed cooperation is of two sorts. With fires already raging, the existing fire brigades must fight the short-run acute problems. But because the existing firehouses, their equipment, and fire regulatory safety codes are inadequate, efforts to rebuild are required to assure that fires can be better fought over the medium and long runs. One's first thought may be to concentrate solely on the acute problems, postponing rebuilding agreements for later. Agreements on how to fight the acute fires of today, however, will not be reached without credible commitments to rebuild the firehouses and regulatory codes for tomorrow. As G-20 leaders plan their April 2nd meeting, they should focus on agreed actions to address the immediate emergency but also on specific commitments to enhance intergovernmental cooperation over the longer run.

If far-sighted, the G-20 leaders will strengthen the powers and stature of international institutions as conduits for their cooperation. For now, the most critical needs are at the IMF, the Financial Stability Forum, and groups charged with responsibilities for supervision and regulation of financial institutions (such as the Basel Committee on Bank Supervision). Such strengthening is very much in the interests of all countries -- large and small, rich and poor. Yet few governments are strongly committed. The United States has not acted as though an effective IMF is essential for supporting its goals and prosperity. The Europeans have been preoccupied with maintaining their disproportionately large share in IMF voting rights and Executive Board seats rather than promoting a stronger, more effective institution. Emerging-market nations such as China, India, Brazil, and Mexico likewise do not perceive the IMF as an institution serving their fundamental interests. Yet those national views are all shortsighted. They underemphasize, if not ignore completely, the fact that appropriate strengthening of the international institutions can advance the collective interests of all nations.

International institutions have not always functioned effectively. They have not been given sufficient authority to conduct multilateral surveillance, and have been timid in exercising the limited powers they do have. Their analytical capacities are not strong enough. For today's world, their governance has major flaws. Despite their weaknesses, however, they can and do play a positive role. In the current crisis, the world community has no better choice than to rely on the institutions and strengthen them as quickly as possible.

A collective bargain among all nations is required to support near-term actions and to reform the institutions for the longer run. It is true that some needed reforms are a zero-sum game. For example, the share in voting rights of many developed countries, particularly in Europe, must fall so that the share of under-represented countries such as China, India, and Brazil can rise. But many other aspects of needed reforms are a *positive-sum* game. Most notably, major developed countries and large emerging-market countries could join together to negotiate a strengthening of the IMF, the Financial Stability Forum, and other institutions that would prove mutually beneficial to all countries in the world.

The remainder of this note identifies specific short-term commitments that could be an initial installment of that collective bargain. Judged from the perspective of the London summit meeting, each component is a short-term "deliverable" for the summit communique on April 2nd.

The G-20 leaders should agree on **(1) a cooperative package of macroeconomic policies, highlighting especially fiscal stimulus programs**. The package should contain a fiscal stimulus program for each country that has policy space to implement fiscal expansion. The programs should contain specifics for each country. Equally important, the IMF should be charged with monitoring the implementation of the specific programs and prominently identifying countries that are not adequately pulling their weight. The leaders should pledge that they want the IMF monitoring to have "teeth." A credible commitment to support IMF monitoring is a promising step that leaders can take to bolster confidence that cooperative policies will mitigate short-run contractions in output and employment. The commitment would also be a downpayment on strengthening the IMF's multilateral surveillance of countries' macroeconomic and exchange-rate policies over the longer run.

The leaders should negotiate **(2) a counterpart agreement for monitoring the commitments of countries to avoid beggar-thy-neighbor policies**. The WTO and perhaps also the IMF should be given an explicit mandate to report regularly on the entire range of countries' policies affecting cross-border transactions. Countries that sail too close to the wind with policies that have protectionist effects, either for goods-and-services trade or for financial transactions, should be named and shamed. G-20 leaders must credibly indicate that they support this monitoring and will not undermine the international reports even if their own countries are criticized.

G-20 leaders should **(3) urgently plan to provide additional resources for IMF lending and to ask for revisions in its terms and conditions**. Substantially larger resources are needed in the short-run emergency, and for the medium term as well. Access and conditionality provisions for IMF lending facilities will require changes. The needs are especially acute for low-income countries and for some emerging-market countries experiencing a severe shortfall in net capital inflows.

Far and away the preferred method for increasing the IMF's resources is to expand aggregate quotas. An expansion of the New Arrangements to Borrow (NAB) is also warranted. But those desirable changes cannot be adopted quickly because they must be preceded by time-consuming negotiations and be accompanied by a major reform in the governance of the IMF (point 4 below).

For the immediate future, therefore, the G-20 leaders have only two practical choices. One is to ask for approval under existing IMF procedures for **(3a) a large one-time immediate SDR allocation**. The size should be at least the equivalent of $200 billion. As an interim step, a large SDR allocation could be implemented promptly without any change in the IMF articles. (It would require an 85% majority of total IMF votes.) An SDR allocation is an imperfect, blunt instrument for an immediate expansion in world liquidity. The largest fraction of an allocation, some two-thirds, would go to countries for whom the direct benefits would be small or non-existent. Nevertheless, the effects for the world as a whole would be unambiguously positive. Because the world financial and economic system faces a severe emergency, the effects of an SDR allocation could help substantively and as a way of boosting short-run confidence.

The other short-run choice for increasing IMF lending resources is **(3b) augmented bilateral borrowing from particular IMF members**. The recent special borrowing of $100 billion from Japan is an initial example that the IMF Managing Director hopes to supplement with analogous borrowings from other high-reserve countries. This approach can help provide immediate resources. But ad hoc borrowings from individual countries are at most an interim step. A major difficulty is that several of the other candidate countries for bilateral borrowings, China being the most prominent, may justifiably prove reluctant to lend in the absence of upward adjustments in their voice and representation in the IMF so as better to reflect their weights in the world economy.

Because of the inevitably close links between additional IMF resources and governance reforms for the IMF, G-20 leaders should pledge to **(4) re-open international negotiations about the financial resources available to the IMF and about the entire range of IMF governance reforms**. A commitment to negotiate comprehensive reforms is primarily a matter of rebuilding the IMF firehouse rather than fighting this year's fires. But that commitment is essential to encourage the necessary cooperation for this year's firefighting (in particular, the active participation of China and other large emerging-market nations). Although a package of reforms was agreed by the IMF membership in April 2008 after three years of negotiations, those reforms were timid and inadequate. Further government and legislative consideration of that package should be deferred. Instead, G-20 leaders should commit the IMF and their Finance Ministers, Deputies and staffs to renewed negotiations over the coming year. The leaders should set an explicit timetable and ask for definite progress by the fall 2009 annual meetings of the IMF and World Bank.

The bold package to be negotiated should provide a major increase in the size of aggregate quotas (at least a doubling); review and expand the arrangements for borrowing under the NAB; refine the terms for member borrowing from the IMF's Short-term Liquidity Facility; revise the terms for members' access to other IMF facilities; incorporate an improved formula to serve as a basis for determining quota and voting-rights shares; revise the composition of the Executive Board and of member constituencies, reducing the number of Executive Directors to no more than 20; eliminate the provision that prohibits split voting within constituencies; reduce from 85% to 80% the required special-majority vote for many key decisions; retain the tripling of basic votes agreed in the April 2008 package; enhance the mandate for IMF multilateral surveillance and macroeconomic oversight of the world economy, including exchange rates; and strengthen the analytical capacities of the IMF staff for conducting such surveillance.

As a credible downpayment on the comprehensive IMF reform to be negotiated in the coming year and as a step to bolster short-run confidence, G-20 leaders should announce **(5) an agreement that leadership selection at the IMF and World Bank will henceforth be solely based on merit, with candidates considered from any nationality**. Leadership selection should require a double-majority voting approval (analogous to that required for approval of amendments to the IMF and World Bank Articles of Agreement.) This agreement would make obsolete the longstanding but now inappropriate convention that European governments designate a European to be Managing Director of the IMF and the U.S. government designates an American to be President of the World Bank. (A joint United States and European Union statement reiterating the agreement could be timed with the G-20 communique.)

Finally, the April 2^{nd} communiqué should reiterate commitment to **(6) reforms of the international institutions with responsibilities for catalyzing cooperation about prudential oversight (supervision and regulation) of financial institutions**. Insufficient time exists prior to the April 2^{nd} meeting to negotiate sound, specific measures in this area. Most such measures in any case pertain to the longer-run task of rebuilding the firehouse and designing better fire safety codes. An immediate step can be taken to broaden the country participation in the Financial Stability Forum and restructure how the seats are arranged around the table. Expansion should likewise occur in the countries participating in the Basle Committee on Banking Supervision, the International Accounting Standards Board, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. The primary responsibility for improved financial standards and prudential oversight, it is true, necessarily resides within individual nations. But the G-20 leaders should build on their November 2008 agreement by credibly committing their countries to intensified cooperation to develop agreed world minimum standards and to provide monitoring and enforcement of those standards.