EMPOWER THE REGIONAL DEVELOPMENT BANKS

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Framing the Issue

There is clear evidence that economic conditions in emerging and developing countries are rapidly deteriorating. In Latin America, optimistic projections suggest no growth for this year in contrast to 4 percent last year. While some countries in the western hemisphere will continue to grow at low rates, others—such as Argentina, Mexico and Venezuela—are expected to contract by as much as 2 percent. In Africa, where the collapse of export prices and the reduction in access to international lending are taking a dramatic turn, a decline seems unavoidable.

Policy Considerations

Containing the ramifications of the crisis from North to South needs to become a focal point for G-20 leaders. If the discussion on the changes to the international financial regulatory and supervisory system dominated the agenda during the November G-20 Summit, now is the time to put together concrete actions to avoid a serious economic setback in low- and middle-income countries. There are good reasons to do this, including the fact that a deep recession in the South will put off the revival of growth in the North.

Protectionism is making matters worse. The "Buy American" clause in the American stimulus bill, the absolute paralysis in U.S. trade negotiations—including the pending trade agreements with Colombia, Panama, and South Korea—and lack of progress in the Doha Round suggest that trade policies in the developed world are not going to help the developing world.

Very few developing and emerging countries have been able to implement the recommendations of the IMF to put in place fiscal stimulus of 2 percent of GDP each year for 2009-2010. The main reason is that, for some countries, private capital flows have come to a halt. Those that that continue to have positive inflows fear losing them if their fiscal deficits go up. Thus, multilateral financial institutions should be ready to increase lending to support aggregate demand and offset any real or potential shortage of private capital.

Action Items for Global Coordination

The top priority is to increase the IMF's firepower. To begin, G-20 heads of state should support the IMF's proposal to set aside a $25 billion facility to assist low-income countries under concessional terms and reduced conditionality. But emerging countries

are likely to demand at least 10 times that figure. To address this situation an agreement should be reached on how to increase IMF resources substantially. Raising the permanent quotas is the natural step but will require a major reallocation of voice and representation, which will not happen before January 2011. Concrete action cannot wait that long.

In the short run, the IMF could borrow from surplus countries, from financial markets, or from the group countries that form the quota-based mechanism known as the New Arrangements to Borrow (NAB). The problem is that an expansion of the current NAB requires legislative approval, at least in the U.S.

Many analysts have argued for a substantial allocation of Special Drawing Rights (SDR). On first appearances, this is a costless and easy solution. But the allocation would have to be proportional to the current quotas which may not reflect the countries' needs. A post-allocation redistribution to countries that need more support is possible but will require time.

In the case of the World Bank, raising more capital will not be addressed until April 2010, when the new governance guidelines should be finalized. Between now and then, the Bank can increase its lending operations by raising more funds in capital markets and widening and streamlining its lines of operation.

Given the complexities associated with the mobilization of resources for the IMF and the World Bank, more emphasis should be given to the capitalization of regional development banks in order to enhance their capacity to assist emerging countries. Contrary to what has been agreed by G-20 finance ministers, this problem goes beyond the capital increase for the Asian Development Bank.

Take the case of the Inter-American Development Bank, which needs more capital even under conservative disbursement scenarios. In contrast to what happens with the IMF or the World Bank, there are no major governance issues to be addressed in terms of chairs and shares. The additional contribution is not large—around a billion dollars in the case of the U.S.—and the payoff can be high in terms of stability in the region. Based on what happened since the last capitalization a decade or so ago, each additional dollar of disbursed capital leverages 90 dollars in development loans. A discussion in the U.S. Congress on the need to capitalize all the regional development banks should not face strong opposition. Of course, it is necessary to get the Obama Administration fully behind the initiative as part of the U.S.'s reengagement with Latin America.

There are too many items in the agenda for the next G-20 summit: financial stabilization, regulatory reform, macroeconomic stimulus, prevention of protectionism, and containment of a backlash in emerging and developing countries. Adequate attention should be given to this last point, which calls for a two-track approach involving resource mobilization for the IMF and, importantly, capitalizing the regional development banks.