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Third World Network

Reality behind the hype of the G20 Summit

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Bonn, 5 Apr (Martin Khor*) -- The G20 Summit in London last Thursday was projected by the organisers and the Western leaders as having agreed to a US\$1.1 trillion package of measures to boost the sagging world economy, and especially to help developing countries.

The trillion dollar figure was what caught the headlines. But as serious analysis shows, this figure purporting to be new money was more hype than reality. Some of it had already been decided long before the Summit, and some of it reflected only an intention rather than concrete pledges.

As an incisive Financial Times article by Chris Giles commented caustically: "Figures at the end of any international summit need to be examined closely, particularly those presented by the UK prime minister. His reputation for numerical inflation, repeat announcements and double-counting precedes him.

"The emphasis on quantities rather than concrete agreements also serves to mask the big missing element in the communique: a new and binding commitment to specific measures to clean up the toxic assets of the world's banking systems."

Rather than the US\$1.1 trillion announced, the new commitments were estimated by Giles to be below \$100 billion and most of those were already in train without the G20 summit. While the inflation of small and old commitments into an enormous amount "does not render the summit a failure, the desire to produce large headline numbers as the main result of the gathering suggests the splits on other issues were considerable," he wrote.

The biggest winner was the International Monetary Fund. It was announced that the IMF would get \$500 billion more funds. Japan and the European Union had already offered about \$100 billion each. The Summit did not formally announce where or when the other \$300 billion will come from, but unofficial and unconfirmed reports indicated that the United States would put in \$100 billion and China \$40 billion.

These would be loans by the countries to the IMF, which will recycle them as loans to crisis-hit countries that are running out of foreign reserves.

There are questions whether countries should give loans to the IMF and whether the IMF will impose the wrong conditions when it recycles the funds to crisis-hit countries.

According to former UNCTAD chief economist Yilmaz Akyuz, countries should not be requested to provide loans to the IMF to augment its resources because this would compromise the ability of the IMF to carry out its surveillance function and to discipline the policies of countries that provide the loans. It can obtain resources from the market or from the issuance of Special Drawing Rights (SDRs), instead of obtaining loans from governments.

The G20 meeting did agree for the IMF to issue \$250 billion in SDRs, but instead of its use to assist countries in need, it was decided to allocate this to the 186 IMF members according to their quotas or voting shares. As a result, 44% will go to the richest seven countries, while only \$80 billion will go to middle-income and poor developing countries.

As many critics of the IMF had pointed out before the Summit, it would be dangerous and counter-productive to augment the funds to the IMF for re-lending to crisis-hit countries if the agency does not reform its policy conditions but continues to insist on policies that lead the countries deeper into crisis, as had happened during the Asian crisis a decade ago.

Unfortunately, the G20 did not insist on any IMF policy reform, but boosted its resources. This may be the most serious error of the Summit.

The G20 Communique states that it will make available \$850 billion to the global financial institutions in order to support emerging market and developing countries, including to finance counter-cyclical spending.

"Counter-cyclical spending" is normally used to mean the kind of significant increases in government expenditure that the United States and Europe are engaged in, as the "fiscal stimulus" to jump-start economic recovery.

The IMF is presumably charged with the new resources to enable cash-strapped developing countries to participate in this fiscal stimulus, which is the newly re-discovered policy formula to get a country out of recession.

However, an analysis by the Third World Network of the nine most recent IMF loans to countries affected by the crisis (including Pakistan and several East European countries) clearly demonstrates that the IMF is still prescribing "pro-cyclical policies" (policies that accentuate the downturn in a recession) of fiscal and monetary policy tightening.

"The Fund's crisis loans still contain the old policy conditions of cutting public sector expenditures, reducing fiscal deficits and increasing interest rates -- which is the stark opposite of the expansionary, stimulus policies being supported in the G20 countries," according to TWN researcher Bhumika Muchhala.

Asia Russell, of the US-based Health Global Access Project, said that "the IMF has imposed disastrous conditions on poor countries that have contributed to massive under-investment in health, HIV/AIDS and education, particularly in sub-Saharan Africa. The G20 must make sure the IMF abandons these policies before infusing the Fund with new resources."

The same day that the G20 Summit was giving a boost to the IMF supposedly to help countries undertake counter-cyclical policies, the IMF suspended lending to Latvia (one of the countries it has recently extended emergency crisis loans to) "until it sees more progress in cutting public spending", according to a news report.

Latvia had agreed to limit its budget deficit to 5% of GDP, but due to the sharp fall in its GDP (by 12% this year, according to latest estimates compared to the 5% estimate when the IMF loan was made last December), the budget deficit could now jump to 12% of GDP.

The incoming government had hoped to persuade the IMF to accept a slightly higher budget deficit of 7% of GDP, but the IMF insisted on sticking to the target and suspended its lending, and thus Latvia is now "racing to prepare more spending cuts", according to the report in the Financial Times.

The Latvia case indicates that the IMF has not changed, and that funds channeled through the IMF are likely to lead to greater economic contraction in countries that take the IMF loans and the attached conditions.

It is thus unfortunate that the biggest result of the G20 Summit is to boost the IMF instead of other more appropriate organizations that can help countries with economic recovery.

The G20 Summit made some progress, though not significant, in other areas, such as expanding the membership of the Financial Stability Forum (renamed the Financial Stability Board) to include developing countries that belong to the G20, agreeing that the heads of the IMF and World Bank need not be from Europe or the United States, and initial measures to regulate hedge funds and rating agencies, and to take note of the status and reports of tax havens that the OECD will publish.

There are several issues that the Summit failed to resolve, besides the biggest omission - failure to reform IMF policies.

First, it failed to produce anything tangible on a coordinated fiscal stimulus policy, which the Americans wanted but which Germany and France objected to. Secondly, it did not come up with a plan of action to clean up the crisis-hit banking systems.

Thirdly, there was no plan for regulating cross-border activities of financial institutions or cross-border financial flows, nor an acknowledgement that a framework should be created that facilitates developing countries' ability to regulate the flow of cross-border funds.

Fourthly, there was no move to assist developing countries to avoid wrenching debt crises through plans to establish a international system of debt standstill and debt work-out, through an "international bankruptcy mechanism". Without this, developing countries would be deprived of the kinds of schemes by which banks or companies in trouble pay back only a portion of their loans whose market values would have fallen.

One positive aspect of the Summit is that a few leading developing countries have become an accepted part of a G20 which thus has better representation than the G8 as a forum for global economic decision-making. Countries like China, India and Brazil are now participants.

Nevertheless, the vast majority of developing countries are absent from the G20 table, and thus the G20 does not have international legitimacy.

The United Nations is the better venue for discussion and decision-making on the global economy and the way out of the crisis, with a greater chance that the interests of developing countries will be taken care of.

The Commission of Experts set up by the President of the General Assembly presented their forthcoming report's draft recommendations, which included proposals for actions that were more relevant to the basic changes required to the international financial system, including changes that would meet some of the critical needs of developing countries.

The UN General Assembly will hold a summit-level session to discuss the global financial and economic crisis and its implications on development in the first week of June. This will be an occasion for a more comprehensive review of and plan of action on the global crisis.

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