Center for Global Development

How to Unlock the $1 Trillion That Developing Countries Urgently Need to Cope with the Crisis

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February 2009

CGD Notes

As commodity prices and exports decline, most developing countries can expect big shortfalls in fiscal revenue this year, meaning that they will not be able to fund the costs of teachers and health workers, let alone their existing bare-bones safety-net programs.

The five billion people living in developing countries are innocent victims of the global economic crisis. Most live in countries with limited resources for stimulus packages, let alone for food stamps and unemployment insurance. This is true even in the many developing countries that have had responsible government and economic management for some two decades.

At the upcoming G-20 summit in London on April 2, we can hope that the world's richest countries will be clear on a coordinated fiscal stimulus and on new resolve to avoid protectionist pressures. No one disagrees that these are fundamental; the only question is how detailed and convincing the political leadership will be.

But finding and deploying resources for emerging-market economies and the poorest countries must also be a top priority if human suffering and social disruption are to be avoided,. With the International Labour Organization predicting that as many as 50 million jobs will be lost in the developing world, and the World Bank projecting zero growth in per-capita income in Africa, the livelihoods of as many as four billion people are at stake.

Already there have been dramatic withdrawals of capital from emerging markets and a drying up of credit, including trade finance. Remittances are declining as immigrants return home. As commodity prices and exports decline, most developing countries can expect big shortfalls in fiscal revenue this year, meaning that they will not be able to fund the costs of teachers and health workers, let alone their existing bare-bones safety-net programs.

The rich-world response has so far fallen short. President Obama and his administration have said little. Let us hope that this silence ends soon, given the new president's inaugural promise to "all other peoples and governments" that "we are ready to lead once more." UK Prime Minister Gordon Brown, who will host the April summit, has been more forceful, at least in rhetoric. And the official donor community and the international financial institutions have also weighed in—but, again, mostly with exhortations. Lacking so far is a signal that they are ready to adjust the bureaucratic customs and rigidities that stand in the way of an agile response.

World Bank President Robert Zoellick made a clever proposal for a "Vulnerability Fund" at 0.7 percent of rich countries' stimulus packages, or about $15 billion for the world's poorest countries. This would require passing the tin cup among the bilateral donors—some of whom (Ireland, Italy, France) are already cutting their aid budgets. Japan, an exception to this trend, announced at Davos plans to increase its foreign assistance to poor Asian countries by $17 billion over three years; perhaps Tokyo will put some of these promised resources into Zoellick's proposed new fund or into the Asian Development Bank. However, even if Zoellick's plan works, $15 billion this year would be far from enough even for just the poorest countries; the fund is not meant to help emerging-market economies at all.

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How much official finance is needed to help the developing world weather the storm unleashed by rich-world regulatory failures? As much as $1 trillion over the next two years would make sense. Dealing with the problems of rolling over sovereign debt, as well as existing bank and corporate debt (some of it implicitly if not explicitly government guaranteed), in Latin America, Eastern Europe, and Asia might absorb as much as half that amount—and of course having $500 billion available might reassure markets and reduce the amounts actually needed.

The other half would be available to fill revenue gaps (which may also rise in countries relying on aid for 20 percent or more of government budgets, if bilateral aid declines) and for emergency job and food programs. This would provide relief and fiscal stimulus that these countries cannot finance through normal borrowing because U.S. government borrowing and bank rescues are sucking capital out of the rest of the world.

To put a half-trillion-dollar developing-world stimulus package in perspective: $500 billion is equal to about 3 percent of the GDP of all developing countries. By way of comparison, the U.S. fiscal stimulus is equal to more than 7 percent of U.S. GDP, and the Chinese stimulus package is equal to more than 10 percent of China's GDP.

Still, a trillion dollars is a lot of money. Luckily, given the political and fiscal pressures that the rich countries' own stimulus packages are creating, it is possible to make $1 trillion available at almost no immediate cost to the traditional donors. The International Monetary Fund and the multilateral development banks already have the wherewithal to put as much as $1 trillion on the table over the next 12 to 18 months. They also have the mechanisms in place to help developing countries to use those resources well. At the April summit, the G-20 heads of state should announce that number—and the steps described at the end of this note that are needed to make that number possible.

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The global community has been slow to recognize the crisis-related need for extraordinary access to finance in the developing world. This may be because of a seeming lack of demand, including from Brazil, Mexico, South Africa, and other emerging-market members of the G-20. Only Iceland (famously) and Eastern European economies appealed to the IMF when their banks were first hit by the financial contagion in late 2008, and then hit again as their local banks' depositors fled to the UK, France, and Germany when those countries shored up guarantees of their banks' deposits.

There are several possible reasons that developing-country demand for finance is not more evident. Perhaps emerging markets fear the effects on market confidence if they resort to an IMF program, or they don't want to absorb the political fallout. Maybe the existing shock facility at the IMF is viewed to be too expensive or too short-term, and countries don't want to use it and lose it too soon in what might become a protracted downturn. After all, Mexico, Brazil, and other large emerging markets welcomed the U.S. Federal Reserve swaps arranged last November; they are now asking for more access to loans at the Inter-American Development Bank (IDB) and have exploited to the maximum the existing option of signing up to borrow quickly at the World Bank.

Perhaps the low-income countries see little logic in going back to the till, assuming that they cannot get more than what's already been allocated from limited concessional funds at the multilateral banks under current rules, or from declining bilateral aid budgets. And of course some economies—including India, Pakistan, and Bangladesh—have been initially less exposed to financial contagion and until recently hoped to escape unscathed.

Whatever the reason for the relative calm up to now (and on capital flight and banking problems, it has not actually been that calm), the need and the demand for outside help is likely to rise fast and soon as virtually all developing countries succumb to the slower-moving but frighteningly growing effects of the global downturn on their real economies.

Where could $1 trillion come from? Here I offer my list, trying to be practical but pushing the envelope:

- **Almost $400 billion**. An issuance of special drawing rights (SDRs—a kind of global currency, especially appropriate when a global deflationary cycle threatens) of $250 billion. This is the number that Ted Truman says can be allocated following a 90-day period of prior consultation with Congress by the U.S. Treasury. Of the $250 billion, just 32 percent (80 billion) would go to developing countries; of that, about $11 billion would go immediately without discussion or conditions to low-income countries (corresponding to the 4.5 percent of IMF quotas they had).

  Another $150 billion is uncommitted in the IMF's new shock facility, and $50 billion can be raised through the IMF's special borrowing facilities. The Japanese are lending $100 billion to the IMF. (It would also help if the IMF management put together a more friendly facility than the current shock one, and if its powerful members signaled readiness for more radical reforms of its governance than are now on the table, as a group of us recently proposed to Treasury Secretary Geithner in an open letter).In short, the total from the IMF in the next 18 months could be $400 billion.

- **Some $300 billion from the multilateral banks' capital**. The World Bank has about $100 billion in "headroom" (the lending it can provide given its capital and its policies that govern use of that capital). Much of that has already been committed using the bank's flexible and precautionary instrument called the deferred drawdown option, primarily to emerging-market economies to help deal with their crisis-related needs. But the amounts have not yet been drawn down, so I include the $100 billion here.

  The amount of similar so-called "headroom" at the regional banks is, surprisingly, not very clear (a troubling fact in itself) but might amount to another $100 billion, particularly if the Asian Development Bank is successful with its planned capital replenishment this spring. The capital of all the MDBs could probably be "sweated" or stretched somewhat, by allowing slightly greater leverage (the banks are not actually "leveraged" at all since their outstanding loans do not exceed their paid and callable capital); perhaps another $50 billion from all of them could be extracted. If the International Finance Corporation and the other private sector arms are sufficiently agile and flexible they might find ways, with guarantees for example, to leverage private flows of another $50 billion. These sums might then amount to $300 billion.

- **Fifty billion from existing concessional resources for low-income countries**. The World Bank's concessional window (the International Development Association [IDA]) was replenished to the tune of $30 billion last year to cover three years of credits and grants. Some of this could be front-loaded to allow an allocation across countries in the next two years of closer to the full $30 billion, suggesting disbursements of as much as $15 billion. Similar front-loading of concessional funds at the Asian and African Development Bank might yield another $10 billion (at the IDB, the concessional window is tiny and is used primarily to subsidize

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hard-window lending). As much as $60 billion in undisbursed funds against approved projects sits in the pipeline at the various banks, according to estimates by Homi Kharas at the Brookings Institution. Perhaps $15 billion of those approved credits and grants could be disbursed this year—by changing project loans into fast-disbursing "policy" loans (as was done for Mexico at the time of the Tequila crisis) in countries with good policy records. Loans from the hard windows of the banks could be made to low-income countries (say up to $15 billion), with IDA and other soft-window resources used to make the terms concessional. This of course would imply somewhat less availability for the emerging markets, though the immediate costs to current emerging-market borrowers would be minimal relative to immediate disbursements to the poorest countries. A better course would be for bilateral donors to commit to buy down the costs of those loans to make them fully concessional, as has been done before and as also suggested by Homi Kharas, generating another $10 billion in new credits and loans. Summing up, $50 billion might be available from these sources.

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That brings the total potential at the IFIs to possibly $800 billion. If some of these funds were used in conjunction with U.S. federal reserve and European Central Bank swaps to central banks in developing countries; if the Chinese were willing to make loans to their Asian neighbors through the IMF or the World Bank or the Asian Development Bank, or through the Inter-American Development Bank to lock in good financial links with Latin America; and if the oil-exporting economies were persuaded to lend to the IMF or to co-finance commercially viable projects with the private arms of the multilateral banks of say $100–200 billion—altogether it is not hard to imagine a total reaching close to $1 trillion. Let's call it $1 trillion.

What is necessary to unlock $1 trillion?

1. The G-20 leaders, and especially President Obama (probably following informal Treasury consultations with the Congress) must give the nod to the IMF to issue new SDRs. Ideally President Obama or Treasury Secretary Geithner would also begin consultations with Congress that would eventually permit assignment to developing countries, if and when the need arises, of the resulting U.S. access to new IMF loans, and other industrial countries would too—but that ideal should not delay the issuance itself which will raise available sums for developing countries immediately as well as build all-important confidence that the global club of nations is able and willing to act in response to escalating needs.) A G-20 announcement to that effect would officially acknowledge the growing needs of many emerging-market economies for help, making it easier for countries fearing IMF "stigma" to begin approaching the IMF. The decision to issue new SDRs would also involve China in a decision of global magnitude at the IMF, a good thing in itself.

2. The G-20 leaders also must call for a temporary emergency suspension of concentration ratios, internal limits on the proportion of MDB loans and grants that can be fast-disbursing, and relaxation of the usual procurement, environmental, and other safeguards that delay World Bank and other multilateral bank disbursements for as much as two years, at the least for countries already eligible for "policy" loans and grants. They should call on the institutions to publish detailed plans of systematic ex post monitoring to minimize abuses.

3. The G-20 leaders should call on the multilateral banks to reassess their options for more effective

use of their existing capital ("sweating" their capital), and on the World Bank International Finance Corporation, MIGA, and the private-sector facilities at the other banks to set targets for leveraging private capital inflows to developing countries in the next 18 months, through guarantees, co-financing, insurance, and other approaches to share risks with private lenders and investors.

4. The major donors (essentially the G-7) should commit to an early replenishment of IDA and other soft windows whose resources end up being front-loaded and to funding in the future the relatively low annual cost of buy-downs of any non-concessional costs of loans made to poor countries in response to the crisis. They should repeat these commitments, and specify their individual country commitments from their future aid budgets, at the July 8–10 summit meeting of the G-7/8 in Italy.

The challenge is not lack of resources but lack of political moxy. At least so far. Luckily, there is still time for the Americans to up the ante with the British hosts, and then for the British to up the ante with the French and the Germans, and the Chinese and Saudi Arabia to match Japan's efforts, and so on. . . .

Further Reading

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Where To Get $1 Trillion

		Amount ($ billions) and target		
	Source	Low-Income Countries	Middle-Income Countries	**Total**
IMF	SDR	11.25	68	
	New shock facility		150	
	Borrowing (NAB/SAB)		50	
	Japanese loan		100	379.25
MDBs	World Bank headroom		100	
	Other MDB headroom		100	
	"Sweat" SMB capital		50	
	IFC and other leverage of private flows		50	300
Concessional MDB Resources	Frontload new IDA funds	15		
	Early disbursement of already approved MDB Concessional Funds	15		
	Loans from hard windows with donor buy down and/or soft window debt service	20		50
Other	MDBs cofinancing of central bank swaps			
	Chinese special loans to MDBs			
	More MDB leverage of private funds		100-200	200
	Total	61.25	868	**929.25**

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