



Foreign Policy Implications of U.S. Efforts to Address the International Financial Crisis: TARP, TALF, and the G20 Plan

**Testimony for the House Foreign Affairs Subcommittee on
Terrorism, Nonproliferation and Trade**

**Nancy Birdsall
President, Center for Global Development
June 10, 2009**

Thank you Chairman Sherman, Ranking Member Royce and other members of the subcommittee. I appreciate the opportunity to appear before the subcommittee today to talk about the foreign policy implications of U.S. efforts to address the international financial crisis, including through the G20 plan.

Introduction

The twenty-first century is bringing tectonic shifts in the world's political and economic landscape. Today's global challenges—disease, human and food insecurity, climate change, and financial crises—do not respect borders; they threaten security globally and at home. Trade, remittances, and private investment tie rich and poor countries together, creating shared opportunities for prosperity but also the potential for shared instability as in our current global economic downturn.

The U.S. cannot hide from these problems nor can we manage global challenges alone or with one or two allies. Rather, we must engage actively in cooperative institutions designed to help member countries manage global challenges through collective action. The G20 leaders recognized the urgent challenge of ensuring that developing countries have the resources to cope with the global economic crisis—avoiding setbacks in Asia, Africa, the Middle East and Latin America that would not only undermine the fight against poverty and disease worldwide but would create the instability and associated security risks for everyone including here at home.

I want to emphasize that what happens in developing countries—where more than 5 billion of the world's 6 billion people live, and where about one-third of world GDP is now produced—matters for Americans' security and for our economic recovery. When former Under Secretary of Treasury for International Affairs Tim Adams and I testified about these issues for the House Financial Services Subcommittee last month, Adams spoke of the risks the poorest developing countries pose for us. He said, "Failed states and extreme poverty breed unrest and instability and create the types of conditions that allow dictators, extremists and terrorists to thrive. In short, it is in our national security interest to ensure that financial and economic crises don't destabilize fragile states." He further explained that many of the recent recipients of International Monetary

Fund (IMF) support (e.g. Mexico, Colombia, Poland, Ukraine, and Pakistan) are key allies and crucial players in the success or failure of our foreign policy and national security objectives.

In the global village we have constructed, we live in the center in what is still the biggest house. We accidentally started a fire at the center that spread quickly to the poorer neighborhoods. We are taking necessary steps to stanch the flames at home but we will not be safe so long as the fire burns elsewhere—it can easily sweep back to our own house. We have a responsibility to protect our global neighbors that is tied to our responsibility to protect ourselves.

I am pleased to be here today to offer my perspective on the foreign policy implications of the G20 recommendations and U.S. response to the international financial crisis. I will focus my remarks on four points:

- **U.S. economic recovery and national security depend on substantially increased resources at international institutions and especially the IMF. The Congress should support fully the proposed increases in resources for the IMF, including the U.S. contribution, which at low cost and risk to American taxpayers, is likely to leverage substantial additional contributions from other countries.**
- **The IMF today is not the IMF of old; additional resources will be used effectively to support stimulus packages and sustained demand in the developing world and in turn support our own economic recovery.**
- **The Congress should endorse the proposed sale of gold to increase IMF resources for financial and other surveillance, and to the maximum extent possible to increase grant and debt relief funds available to low-income countries.**
- **The Congress should urge the Treasury to take the leadership in negotiating, particularly with the recalcitrant Europeans, the governance reforms endorsed by the G20 heads of state, in part because this is likely to trigger increased contributions from China and other emerging market economies, thus reducing even further the potential burden on the American taxpayer.**

I. U.S. economic recovery and national security depend in part on substantially increased resources at international institutions and especially the IMF.

There are two reasons why the U.S. should support multilateral financial institutions, and especially the IMF, right now.

- First: The U.S. recovery from the economic crisis depends not only on our own stimulus package, fiscal and monetary policy and credit and related programs to sustain domestic demand, but on sustaining demand abroad, including in emerging markets and developing countries.
- Second: U.S. prosperity and in the broad sense U.S. security beyond the crisis rely on the open, rules-based international economic order created under our leadership at the end of World War II. The IMF plays a key role in that order, and that order in turn supports the safer, more prosperous and more humane global community Americans want beyond as well as within our borders.

Ensuring our economic recovery

Emerging market and developing economies have driven much of recent world growth. In 2008, U.S. growth relied almost completely on our exports—about one-third of which went to China, India, Brazil, Mexico and other emerging markets. An estimated 10 percent of U.S. jobs—about 12 million—depends directly on these exports. Now those markets are experiencing dramatic withdrawals of capital and 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 nets.

Helping emerging and developing countries to cope is in our national interest. President Obama explained in his letter to congressional leaders about the G20 commitments that lower global growth, as in the Asian financial crisis, will cause U.S. growth, jobs, and exports to fall more sharply. Collapsing economies overseas will exacerbate the contracting economy at home. Stimulating the global economy is vital for our domestic recovery.

Beyond the crisis: a safer and more humane global community

Continued economic growth in the developing world is not only good for our economic recovery. Economic growth in the developing world reduces the risks of social and political unrest abroad and shores up countries' own efforts to help their own people escape poverty. It also strengthens governments' ability in low-income regions to participate in international programs to strengthen disease surveillance and combat drug and sex trafficking. (Consider how fortunate the U.S. is that its neighbor Mexico handled quickly and effectively the outbreak of the recent influenza virus.)

Now economic growth abroad is threatened by what began as a financial crisis in the U.S. Most of the more than five billion innocent victims of this crisis live in developing 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.

In sub-Saharan Africa, for example, where the number of democracies has risen from just three in 1989 to 20 today, governments are increasingly committed to sensible macroeconomic management and effective health and schooling programs. They have achieved faster economic growth, continued reduction in poverty rates and improvements in social indicators. But they are not in a position to borrow to support countercyclical fiscal spending, the poorer among them face likely declines in bilateral aid, private capital has withdrawn (in a flight to the relatively safe haven of U.S. treasuries) and their governments cannot borrow on dried-up private capital markets. For the poorer countries especially, external resources are critical to avoid extensive human suffering and political instability. The International Labor Organization predicted earlier this year that as many as 50 million jobs will be lost in the developing world (and that estimate has probably risen with a reported 20 million jobs lost in China export industries alone). The World Bank is projecting zero growth in per-capita income in Africa.

The United States, as the catalyst for this crisis, has a particular responsibility to help poor countries cope with the fallout. Though in the major developing countries there is as yet no sign

of rejection of our market-based and democratic model, it is not surprising that their leaders and their peoples look to us for leadership in helping those with fewer resources to cope. Were we to walk away from that leadership, a backlash of anger at the United States and opposition to U.S. values, institutions, investment and trade could develop; certainly the leaders of Venezuela, Iran and even Russia might exploit the situation in ways against our interests.

The role of the global financial institutions

To return to the metaphor I used at the start of my testimony, I'd like you to think of the IMF as the fire brigade in our global village. That is the approach that the G20 leaders took. They resolved to rapidly increase the fire brigade's resources to minimize the risks of the financial fire spreading worldwide and damaging everyone – and strengthen its capacity to participate in a more effective regulatory regime within and across countries to minimize the likelihood of future fires. They also acknowledged the importance of the work of the World Bank and the other multilateral banks in supporting continued and compensatory spending in affected countries on social safety net programs and infrastructure and other investments to speed recovery.

What this means in terms of resources for the IMF

Leaders from more than 20 major nations resolved in the April G20 London Summit communiqué to make available an additional \$1 trillion through the IMF and other institutions to help developing countries cope with the global financial crisis.¹ The Obama administration played a key role in getting the ball rolling in March when Treasury Secretary Timothy Geithner urged that IMF member countries agree to a \$500 billion increase in the amount the IMF can borrow from members through the New Arrangements to Borrow (NAB) emergency financing mechanism and indicated he would seek \$100 billion from the United States.

President Obama has asked Congress to include provision for the \$100 billion loan in legislation as early as possible and I urge this subcommittee to support that request. The U.S. contribution will help ensure other announced contributions: \$100 billion from the Europeans, another \$100 billion from Japan (additional to \$100 billion announced prior to the London Summit, see <http://www.imf.org/external/pubs/ft/survey/so/2009/NEW021309A.htm>), and smaller contributions from Canada, Saudi Arabia, and others. The “contribution” from the U.S. would have a minimal effect on the U.S. budget; when the U.S. contributes to the NAB, Treasury receives an interest-bearing account at the fund in return. I understand the current plan is to score the \$100 billion contribution as \$5 billion on the federal budget. The \$5 billion scored on the budget is likely to leverage a total of \$500 billion increase in the amount the IMF can borrow through this emergency financing mechanism.

The G20 leaders also agreed to IMF issuing \$250 billion in new Special Drawing Rights (SDRs— an IMF asset based on a basket of key currencies against which member countries can borrow). Issuing new SDRs is the equivalent of creating additional international liquidity for IMF member countries, a reasonable idea when many credit-worthy sovereigns have poor access to credit, exacerbating the downturn and increasing the risks of global deflation. An allocation

¹ I proposed that \$1 trillion could and should be made available in mid-February (“How to Unlock the \$1 Trillion that Developing Countries Urgently Need to Cope with the Crisis” at <http://www.cgdev.org/content/publications/detail/1421143>), primarily by exploiting then-current resources but also by channeling reasonable amounts of additional resources from the U.S., Europe, and China and other surplus reserve countries through the IMF and multilateral development banks.

of \$250 billion is permitted under U.S. law following a 90-day period of consultation with Congress; I understand Treasury informed Congress on April 13. SDRs are allocated to countries in line with their current “quota shares” in the IMF. 32 percent of the \$250 billion (\$80 billion) would be available for developing countries, including about \$11 billion for low-income countries (corresponding to the 4.5 percent of IMF quotas they have). I support the idea of an additional \$250 billion of SDRs being created and called for this before the London G20 summit.² Today, I urge the Congress to endorse this move.

II. The IMF today is not the IMF of old.

Congress is currently considering legislation in the war supplemental that stems from the G20 summit and calls for a major increase in resources at the IMF. I thought it would be helpful for me to address some of the concerns I have heard from members of Congress (including in the “Dear Colleague” letter signed by several of you on the subcommittee).

First and foremost, the IMF of today is not the IMF of old. In particular in response to the global economic crisis, it has recognized the logic of supporting deficit spending during a downturn, has encouraged and indeed urged countries to protect their spending on health, education and the social safety net in general. The IMF Board has approved creation of a new precautionary facility (the Flexible Credit Line or FCL) that makes substantially more resources available more quickly on better terms, on request, to countries with an adequate record of good policies and sound management.³ Fiscal targets have been loosened in 18 of 23 African countries with active IMF programs. On average, fiscal deficits are widening by 2 percent of GDP.

The FCL is one of a series of steps the institution is taking that are making it more pragmatic and responsive. My understanding is that the IMF is developing a proposal to finance temporary relief from interest payments on debt for low-income countries hit by the crisis.⁴ I strongly support this idea and hope the U.S. will back its endorsement by the IMF Board.⁵

I am particularly impressed with the increasing attention in IMF programs to the economic logic of protecting social program spending during downturns. The IMF has long come under fire from critics concerned that IMF programs in low-income countries unnecessarily limited health spending, hurting poor people. A report by my colleague David Goldsbrough at the Center for Global Development who led a working group on the IMF and health spending, found that IMF

² See Nancy Birdsall, “How to Unlock the \$1 Trillion that Developing Countries Urgently Need to Cope with the Crisis,” Center for Global Development, February 2009, <http://www.cgdev.org/content/publications/detail/1421143>.

³ The FCL is available for countries that pre-qualify based on rigorous policy criteria and track records for good implementation. So far, Colombia, Mexico and Poland have been approved for the FCL and other good performing countries are likely to gain future approval.

⁴ This is akin to an approach I encouraged in testimony before the Senate Foreign Relations Committee on the Jubilee Act for Responsible Lending and Expanded Debt Cancellation of 2007. I called for the Senators to encourage the U.S. Treasury to work with its counterparts in the World Bank and IMF to develop a facility, possibly at the IMF, that would provide temporary financing to relieve debt service burdens in the case of shocks to low-income countries’ economies beyond their own control. See “Building on International Debt Relief Initiatives: Testimony for the Senate Foreign Relations Committee”, April 2008, <http://www.cgdev.org/content/opinion/detail/15880/> and Nancy Birdsall and Brian Deese, “Delivering on Debt Relief,” Center for Global Development, April 2002, available at <http://www.cgdev.org/content/publications/detail/2862/>.

⁵ CGD’s first book, *Delivering on Debt Relief: From IMF Gold to a New Aid Architecture* by president Nancy Birdsall and John Williamson, a senior fellow at the Peterson Institute for International Economics, proposed a similar idea. See <http://www.cgdev.org/content/publications/detail/2922>.

programs could have important indirect effects on the health sector through the size of overall public spending and other influences.⁶ He and the working group urged the IMF to be more ambitious in exploring policy options for higher spending and aid and to drop wage bill ceilings except for the rarest circumstances where loss of control of payroll threatens macroeconomic stability.

Today's IMF programs no longer include binding structural conditionality but they do include targets to *preserve or increase* social spending. IMF programs have promoted higher social spending in countries like Costa Rica, Guatemala, and Pakistan that aim to strengthen social safety nets. The IMF Board, in June 2007, also emphasized a longer-term view of spending plans in developing countries, including attention to protecting priority expenditures from adverse shocks and reducing the use of wage bill ceilings. Today, none of the IMF programs in the 31 low-income countries includes a wage bill ceiling as a performance criterion and only four include indicative targets on the wage bill. All of these efforts are helping to buffer developing and emerging countries from the effects of the global financial fires.

III. Support the sale of IMF gold to strengthen surveillance and help poor countries

Low-income countries are suffering disproportionately as a result of the global financial crisis not of their making, as acknowledged by several of you in the letter on these issues. House Financial Services Committee Chairman Barney Frank, other members of Congress, and development advocacy groups like ONE have argued that the IMF should ensure that some of the revenue from the sale of IMF gold and/or other sources of income be used to provide funding for the world's poorest countries. President Obama has also requested congressional approval for the sale of a limited amount of the IMF's gold reserves, for two purposes: to support an endowment at the Fund, explained below, and to increase the Fund's resources for concessional lending to low-income countries.

As I said in my testimony last month before the House Financial Services Subcommittee on International Monetary Policy and Trade, I urge the committee to recommend approval of the gold sales request and provide guidance to the Treasury for its discussions with other IMF members on the allocation of the sales revenue between the two purposes.

In 2008, the IMF Board agreed, subject to approval by its members, to the sale of a small amount of its gold to finance an endowment account, the annual returns to which would be available to support the administrative costs of two key public goods the IMF provides: periodic surveillance of countries' macroeconomic and financial situations, and capacity building. Effective surveillance is a core IMF duty and no more so than now, when the IMF is assessing whether the macroeconomic and financial sector policies of its members are adequate given the crisis. The surveillance function can be thought as equivalent to the fire brigade checking to see if fire alarms are working and buildings are up to code. A strengthened IMF surveillance function would not only help individual countries to avoid big mistakes and but also help identify—*before a crisis strikes*—systemic risks to global financial stability.

⁶ "Does the IMF Constrain Health Spending in Poor Countries? Evidence and an Agenda for Action," David Goldsbrough, Center for Global Development, July 2007, <http://www.cgdev.org/content/publications/detail/14104>.

For this to work, the IMF needs dedicated funding for independent surveillance on an ongoing basis, not only in times of crisis. In the past the surveillance and capacity building functions have been supported by income from the IMF's loans. But the ability of the IMF to carry out these key functions should not be a function of member countries' needs to borrow (which ideally will return within a few years to being relatively limited) nor on the cost of borrowing, which should be as stable and predictable for borrowers as credit markets allow.

The board of the IMF has endorsed the sale of gold including in order to generate resources for an endowment—apparently in an amount of about \$6 billion. (A target amount of \$6 billion in income for an endowment fund would generate annual income on the order of about \$200 million, an amount that today would cover about 20 percent of current annual administrative expenses.) The exact amount that would be available for support to low-income countries depends on the price of gold at the time of sales over the next several years, and the allocation for the endowment already agreed by the IMF Board.

To summarize, I believe Congress should authorize IMF gold sales for the two purposes, and provide guidance to Treasury along the following lines: to ensure the proposed endowment is adequately funded and to support use of any additional revenue from gold sales and/or from other revenue sources to increase as much as possible resources available to low-income countries, ideally for grants or relief of interest payments on debt.

IV. The Congress should urge the Treasury to take the leadership in negotiating, particularly with the recalcitrant Europeans, the governance reforms endorsed by the G20 heads of state; among other benefits this is likely to trigger increased contributions from China and other emerging market economies, thus reducing even further the potential burden on the American taxpayer.

The global financial crisis requires a global response not unlike what the IMF was designed to do after World War II. But while the economic weight of countries has shifted dramatically since the 1940s, IMF decision-making rules have remained largely unchanged. Belgium and the Netherlands together have more voting power than China; Belgium alone has more voting power than India. The allocation of quotas (votes) and the make-up of the board, where Europe holds 9 out of 24 seats are among the out-dated mid-twentieth century governance arrangements that have seen the rising Asian powers withdraw in spirit if not yet in fact from the IMF orbit. A continued withdrawal would be the canary in the mine – making the IMF irrelevant and ineffective in addressing the current crisis and averting future global financial disruptions.

That would be a big loss for America and its citizens and taxpayers. No country stands to gain more from a legitimate and effective IMF than the U.S. Strengthening the IMF's role in supporting global economic recovery and restoring global economic and political stability will only be possible if major emerging market countries believe they will soon secure appropriate influence in IMF decision-making. The G20 leaders recognized this implicit link at the summit in April and their call for additional resources for the IMF is twinned, smartly, with calls for governance reform.

The IMF Board last year approved a proposal for revision of IMF quotas (voting weights that determine contributions to IMF resources and access to IMF financing) to begin increasing the quotas of several underrepresented emerging markets. The reform requires congressional approval and the Obama administration has asked for that approval. The proposed changes are very modest (e.g. China's voting share would increase from 3.7 to 5.6 percent); they are sometimes called "a mouse" compared to the extent of reforms needed.

Despite the modesty of the reform efforts, I believe that Congress should now endorse the proposed 2008 governance reforms as a first step, a down-payment, towards broader governance reform. The G20 called for the next review of IMF quota reforms to be completed by January 2011; an IMF internal report moves this forward to 2010. The U.S. should support an accelerated review process and urge further changes, which can in turn push the Europeans towards accepting deeper reforms—including the important step of reducing the number of board chairs they currently occupy.⁷

Conclusion

As this subcommittee and your colleagues consider how best to support the spirit of the G20 commitments and global economic recovery, I urge you to keep in mind three things:

1. **Stimulating the global economy—including in developing and emerging countries—is vital for our domestic recovery and security, and it is urgent.** While I believe that there is more work to be done to tie additional resources to governance reform, I fully support the administration's efforts to move the IMF funding bill as quickly as possible through Congress in order to support the IMF's critical role in helping stabilize and monitor the global economy. The human impact of the global crisis will be dire, but the cost of inaction will be even greater for global economic and political stability. Congress should support expeditious approval of the administration's requests stemming from the G20 summit, including providing additional resources to the IMF. Congress should also recognize the enormous leveraging power its contributions to the Fund create—a small contribution from the U.S. will be matched with enormous resources from around the globe in a world-wide effort to stem the worst ramifications of the crisis.
2. **U.S. congressional support for the G20 commitments, including additional IMF resources, is critical for reshaping our image in the world.** Many blame the current crisis on the U.S. and are looking for U.S. leadership to respond. The administration took a significant step towards coordinated, global response to the crisis at the G20, and congressional support is needed to maintain U.S. credibility in leading a global response to the crisis. The U.S. has traditionally played an important role in the global institutions and helps strike the right balance between generosity in our self-interest and avoiding throwing money down the drain. The U.S. has been a particularly strong leader in insisting on accountability and standards for lending through these institutions. The U.S. has the opportunity and responsibility to continue to lead in these institutions and ensure an effective, coordinated global response to the crisis.

⁷ As recommended in the Trevor Manuel report: <http://www.imf.org/external/np/omd/2009/govref/032409.pdf>.

3. **Monitor but don't micromanage further IMF reforms.** Further and deeper governance reforms are needed at the IMF, but I worry that the tendency for Congress to dictate what the IMF can and can't do undermines the U.S. role in global institutional decision-making and ultimately weakens the effectiveness of the IMF. Interest, advice and close monitoring of the IMF by Congress are critical, but the U.S. executive director reporting to the Treasury Secretary should be permitted enough flexibility to be a credible player in IMF decision-making. If the U.S. executive director is overly constrained by Congress from the outset, she or he loses the ability to negotiate and thus play an effective leadership role among our allies and partners.

In an increasingly interdependent world, economic growth, improved well-being and good political relations with developing countries—where five of six people in the world live—are fundamental to sustaining and increasing the economic opportunities Americans enjoy and to reducing the threats we face. In this context, shared institutions matter more, and a better approach to organizing and supporting these institutions can have high returns for the goals and interests of the United States.

The challenge is to use America's still substantial influence to reform international institutions into effective organizations for collective, global problem solving. The G20 members, with substantial leadership from the U.S., have taken the first steps towards strengthening the IMF's ability to provide the global public good of financial stability for all. I hope that the Congress and the administration continue to support strong U.S. leadership on these issues and believe that we and our fellow global citizens stand to benefit greatly from these steps towards more legitimate and effective global institutions.

This committee knows well the important relations we have with emerging and developing countries, particularly related to trade and the fight against global terrorism. The G20 plan, including support for resources and reform at the IMF, is vital to our domestic economic recovery and to security globally and at home. While many blame the U.S. for the current crisis, we can and should leverage our leadership and resources through global institutions like the IMF to respond to the current crisis, help restore the U.S. image in the world as a global partner, protect our shared economy, and promote our common security.