



A “Grand Bargain” at the G-20

Morris Goldstein explains why a “grand bargain” between developed and developing nations at the G-20 summit in April could arrest the downward slide in the global economy.

Recorded February 20, 2009. © Peterson Institute for International Economics.

Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Our guest on Peterson Perspectives today is Morris Goldstein, senior fellow at the Peterson Institute, who has been studying plans for the upcoming G-20 Summit of the leading 20 nations and economies in the world in April in London to deal with the global financial crisis, and he has some ideas on how they can address the crisis.

Thank you for joining us, Morris.

Morris Goldstein: Delighted to be here, Steve.

Steve Weisman: Morris, you’ve come up with the idea that this summit can really accomplish something by establishing what you’ve called a grand bargain essentially between the developed countries and the developing and emerging countries. What would this grand bargain entail, first, in terms of what the developing countries would bring to the table?

Morris Goldstein: The developing countries are going to see this global financial crisis as a strong message that the world is a riskier place, and they’re going to want better insurance against that risk. So what the grand bargain would offer them is larger IMF resources, higher borrowing limits from the Fund so they could get more when they were in trouble, less reliance on the Fund’s lending windows that have very high conditionality. So instead of having to deal with that conditionality, they could get some of their resources from an SDR allocation.

Steve Weisman: SDR is?

Morris Goldstein: Special drawing rights, which are really not conditional, or from a lending window called the compensatory finance window, which gives you funds when you have an export shortfall. But again, it’s frontloaded, it’s not conditional.

Steve Weisman: The developing countries have some bad memories of dealing with conditionality in loans from the IMF.

Morris Goldstein: That's right. They have memories of the Asian crisis and particularly right now, there is a stigma associated with going to the Fund. So if you can tilt the mix somewhat away from the more high-conditionality lending windows to the less conditional ones, that's attractive to the emerging economies.

Steve Weisman: Essentially, these conditions forced them in the past to adopt austerity measures that were very painful, isn't that right?

Morris Goldstein: Yes, I think some of them were needed, but in any case, right now what they would like is large amounts of money subject to weaker lending conditions, so you need to put that in the package. In this connection, the Fund has also recently established a short-term lending facility, but the emerging economies didn't like it because the repayment periods were too short. They wanted longer repayment periods. They wanted to be able to access it in a precautionary way so it would be there, and when you needed it, you could just activate it.

Steve Weisman: Sort of like a line of credit.

Morris Goldstein: Right, but it wasn't really set up that way so they would like that. They would like a representation in the Fund and voting power in the Fund that's commensurate with their growing weight in the world economy.

Steve Weisman: Right now, the Fund's voting is weighted toward the Western countries and heavily weighted toward Europe. They would like it more represented by other developing countries like China and the emerging markets. Is that right?

Morris Goldstein: That's right. There was an agreement to give them a small increase last year, but it's still way below what they would like, and I think we need to increase that. So in the end they would get better insurance against crises from the Fund and better representation so they would have a greater say in the rules that were set. And the idea of providing insurance this way is that then developing countries would be less inclined to get the insurance by trying to build up a big stockpile of reserves by keeping their exchange rates very undervalued, which the advanced countries don't like.

Steve Weisman: Part of the diagnosis of the current crisis is that China and other developing countries built up these big reserves because of their export-driven economies, and that appears, at least by some analysis, to have contributed to the current imbalances and crises.

Morris Goldstein: I think that's right, and so when you go to the advanced industrial countries' side of the bargain, what they want is the emerging economies to play by the agreed international rules of the game.

Steve Weisman: What do you mean by that?

Morris Goldstein: On exchange rates, you're really not allowed to engage in protracted large-scale intervention in exchange markets to keep the value of your currency low.

Steve Weisman: Some countries are, in your view, guilty of that.

Morris Goldstein: Yes. There have been some prominent examples of that in the past that run against the IMF guidelines, and there's also guidelines on trade policy via the WTO. So the quid pro quo for the advanced countries is, well, if we can get the emerging economies to play by the rules, then we will have less of an incentive to get the kind of insurance against some of the difficulties we're having in other ways. For example, we won't need to do "Buy American" or "buy local" in government stimulus programs. We won't have to say to banks, we're in a credit crunch, don't lend to other countries, lend mainly at home. So again, if you get some insurance the right way, you're less inclined to go for the beggar-thy-neighbor-type solutions. So that's really the idea of the grand bargain: to make the incentives such that both sides see it in their interest to avoid beggar-thy-neighbor policies. Then finally to wrap up the grand bargain, we would also have the pledge for a fiscal stimulus of at least 2 percent of GDP for two years running to support demand.

Steve Weisman: By all of the countries.

Morris Goldstein: All of the countries.

Steve Weisman: How many countries are engaging in stimulus programs on that level? The United States and China, we know are. But are there other countries?

Morris Goldstein: People haven't really done the tally yet, and we want to make sure we're comparing apples to apples and that we've got a common benchmark. We want the IMF and the OECD to monitor these numbers, to tell us who's actually doing the 2 percent of GDP for two years running, so that we get an honest scorecard here. But if we get that, then we have something to expand global demand, and if we get all the countries again to agree not to impose any beggar-thy-neighbor policies in trade, or in finance by an industrial policy, then I think we've got a chance for a good deal.

Steve Weisman: It sounds like a grand bargain of this kind could be seen as marking a real success story for the G-20 process. But what chances are there of this actually happening?

Morris Goldstein: Well, just this past week, Prime Minister Gordon Brown of the United Kingdom has come out for a grand bargain, really very much along these kinds of lines. So you certainly need the host to be in favor of it. That's a necessary but not sufficient condition. But I think you can get more, given that we're in such a deep global financial crisis. I think countries realize, advanced and developing alike, that you have to do something different. We have to change the existing architecture, and we really need to avoid these beggar-thy-neighbor policies, otherwise we're going to get in this vicious circle where we just get the downward spiral.

Steve Weisman: A final question: What leadership is brought to bear in Washington to achieve this objective?

Morris Goldstein: I would hope that the US Treasury and President Obama would also agree to support a grand bargain of this type because I think it would be in the US interest as well. We're trying to get out of a recession. It'll be easier to do so if other countries are also undertaking fiscal policy expansion. It'll be easier to do so if our overseas markets are not contracting unduly. So I think it would be a very forward-looking step.

Steve Weisman: Morris Goldstein, thank you very much for joining us today.

Morris Goldstein: Thank you.

