



Financing Woes for the Developing World

Arvind Subramanian says developing countries have many reasons for resenting the IMF, but they need to work together better to achieve reform at the Fund.

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Our guest on Peterson Perspectives today is Arvind Subramanian, senior fellow at the Institute. We're going to talk about the agenda of the developing world at the upcoming summit of the G-20 nations.

Arvind, there's been some talk that the developing world has not only been hard hit by the global economic crisis but also by the tactics of the United States, namely the fact that the United States is borrowing so much for its stimulus and deficit and current account problems. Do you see the United States, in effect, "crowding out" the external financing markets for the developing world?

Arvind Subramanian: That's a good question, Steve. Now, one has to distinguish two things. First of all, when the crisis unfolded, there was a massive deleveraging process and a process in which foreign capital in developing countries, emerging-market countries, bolted these countries and so led to a huge liquidity shortage in many, many countries, including Asia, Latin America, Eastern Europe, and so on. That was the first phase of the crisis. And that did induce a huge liquidity crunch, so no doubt that created financing problems for many of these countries.

But the question is: Is that true now as well? And the answer is a little bit more nuanced and mixed. What's happening now is that it's not obvious that around the world, especially in Asia, there is a liquidity crunch.

Eastern Europe is still experiencing a capital shortage because its banking system is a mess, people are worried about whether the balance sheets are sustainable, banks are overexposed, and corporates are overexposed.

But in Asia, what we find is that this is not the case. What is happening in fact is that interest rates have come down sharply in Asia. Now, if there were a capital shortage, you would find the price of capital going up, interest rates going up. That's happening in, as I said, Ukraine, Hungary, Latvia, even Russia, and to some extent in Brazil and Mexico. But that's not what's happening in Eastern Asia and so I feel that the whole question of the United States crowding out developing countries is painting with too broad a brush because it doesn't apply to Asia at the moment.

- Steve Weisman: Now the borrowing needs in Asia seem to have gone down at the same time as the deleveraging. That's for what reason?
- Arvind Subramanian: That's exactly right, Steve. What has happened is that because growth has collapsed, trade has collapsed, the demand for borrowing has also declined and that's what explains the decline in interest rates. In fact, policymakers are scrambling to revive this demand by lowering interest rates. A good example: You hear a lot of talk now about how trade financing is drying up. Well, if trade collapses on the order of 30 or 40 percent, it's not at all surprising that the demand for trade financing is collapsing. So the collapse in trade financing is derivative to the collapse in trade rather than the causation being the other way around.
- Steve Weisman: We're headed into a G-20 meeting in a few weeks in London. G-20 of course stands for the Group of 20 nations, several of which are members of what we call the Trillion-Dollar Club here at the Institute: the major emerging markets. What is their agenda at the G-20 summit? And what are the chances of them making progress on achieving their objectives?
- Arvind Subramanian: I think if you look now at the agenda following from yesterday's US Treasury announcement, I would say that the current agenda is the three R's...
- Steve Weisman: When you say yesterday's announcement...
- Arvind Subramanian: The announcement from March 11. Treasury Secretary Geithner put forward the US proposals for the forthcoming G-20 summit. Now, what they have in mind for IMF reform, for example...
- Steve Weisman: You've summarized that in what way?
- Arvind Subramanian: I call it the three Rs. Reflation: The United States and many other countries want a fiscal stimulus done globally, of sufficient magnitude, about 2 percent of world GDP, and coordinated and monitored subsequently by the IMF. So that's the first R, reflation. The second R is resources. The IMF has asked for and the world thinks that the IMF should have more money to lend to countries in trouble. At the moment, the IMF has something like \$250 billion to lend out. They want to increase it to \$500, perhaps even \$750 billion. So that's the second R. The third R, on which Europe is very keen, is regulation, i.e., some global person or global agency to regulate the financial sector to prevent the recurrence of the problem that happened, that led to this crisis in the first place. So reflation, resources, and regulation.

Now, the emerging-market perspective I think is the following: I think they are just as keen on the fiscal stimulus, because, as I just said, exports are collapsing so they want demand to revive worldwide so that their exports can increase. But there is one R there which is very important to them, which is not missing but is kind of underplayed: representation or what I would call the whole governance agenda.

I think there is a serious problem with the IMF, which is that large parts of emerging Asia and emerging Latin America think that it is not their institution. They don't have a stake in it and therefore they're not engaged in it. And unless, I think, the reform addresses that question, I think in the long run, the IMF will not have a bright future.

Steve Weisman: China, India, Brazil, and to some degree Russia, Have they managed to unite around a position on this?

Arvind Subramanian: Good question, Steve. Because again, I think the program here is on both sides. These countries, Russia, China, India, and Brazil, need to be much more fully represented in terms of their quota shares, in terms of their voice on the IMF Board and so on, in terms of who becomes the head of the institution. All these are very important governance questions.

But on the one hand, the existing powers, I think, are very reluctant to cede power to the newly emerging economies, commensurate with the economic power frankly of the Trillion-Dollar Club. Just to give you an example: Belgium has a much bigger quota share than India. I kind of jokingly say that if the political problems in Belgium had actually come to pass and it had split into Wallonia and Flanders, each of them would have had a bigger say in the IMF than Brazil and India. And Wallonia is like one suburb of New Delhi, you know. And that's kind of how absurd the current representation is. So that's the problem on one side, with the industrial countries not relinquishing control out of a sense of enlightened self-interest.

On the other hand there is a problem also with these emerging-market countries. They're not asserting themselves in a way that you would expect them to. Why that is the case, one can only speculate on. But unless they are more assertive about what I call the fourth R, the representation issue, I'm afraid that if you don't ask for it, you don't get it.

Steve Weisman: I should have mentioned Mexico and Korea. I mean it's not just those countries. But they have done a poor job of organizing themselves. And you also have written and said that it's not just a matter of symbolic importance, this representation. There's a real perception that the IMF has a double standard toward the developing world in comparison to European countries that are now in trouble. Can you explain a little bit about that?

Arvind Subramanian: Yes. Steve, this relates to my point about why I think it's in the enlightened self-interest of the industrial countries to try harder to reengage these emerging-market countries. For example, I think on regulation, on exchange rates, the United States and Europe want the IMF to play much more the role of a kind of a referee or an arbiter. And I think there is a good case to be made for that. But I think there's going to be tremendous pushback from emerging-market countries on this aspect, because why would they think of giving more power or more authority to an arbiter that they don't trust in the first place?

And this kind of double standard that you were speaking about, I have one good example. In the recent program that the IMF had with Latvia, Latvia had a current account deficit of 24 percent of GDP. That is huge. That means it's basically lived way beyond its means. Now, usually when this happens, the IMF comes and says, well, you have to adjust your exchange rate because that's part of the adjustment process. In the case of Latvia, the IMF said, "No, you don't have to adjust your exchange rate at all." Now, I don't want to go into the merits of the case, because there is an argument for saying that they shouldn't have to change their exchange rate, because they have a lot of foreign currency liabilities and when you depreciate your exchange rate, these become much more expensive to service in domestic currency. That's what happened in East Asia in the 1990s crisis.

But leave aside the merits of the case. What emerging-market countries are asking themselves is, if they had come to the IMF under similar circumstances, and if they didn't have friends in high places, would they have received the same treatment from the IMF or not? And frankly, they don't think they would have. So with this kind of perception of double standards, they are extremely reluctant and would in fact be loath to give more authority, regulatory authority, to the IMF.

Steve Weisman: What, finally, are the chances of any progress being made at the G-20 on these issues?

Arvind Subramanian: I think on the resources question, expanding the size of the Fund, I think we are going to make progress. I think we may not make a lot of progress on the details of global regulation of the financial sector. I believe we're going to get some changes on the governance side. I mean, these are going to be good starts. But this is not the kind of overhaul of governance that this institution requires. But things like next time around and in the future, appointing the heads of institutions through a merit-based process rather than say, the IMF head will go to Europe and the World Bank head will go to the United States, no. I think there is a greater convergence of views on that. I think that's a good start. But frankly the governance needs a much more radical overhaul than just tinkering.

Steve Weisman: Arvind Subramanian, thank you very much for sharing your thoughts on this with us today.

Arvind Subramanian: Thank you, Steve.

