

**Testimony by Tim Adams**  
**House Committee on Financial Services**  
**International Monetary Policy and Trade Subcommittee Hearing**  
**“Implications of the G-20 Leaders Summit for Low-Income Countries and the Global Economy”**  
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**Overview of the crisis and its impact**

The economic and financial crisis that has engulfed the United States over the past year continues to cascade throughout the global economy, producing a painful, sudden, synchronized global contraction. The IMF has once again revised downward its estimate for global growth in 2009 to a negative 1.3%, which is the most acute global recession since the Great Depression. Many noted private forecasts are even more pessimistic. The World Bank estimates that global trade will decline 6% this year, the largest decline in 80 years. The likely global wealth loss from this crisis could exceed \$50 trillion, which is more than global GDP.

The G7 economies, which compose roughly half of global GDP, are experiencing the first synchronized recession in the post-war era. The U.S. economy will likely continue to contract during the current year, even with a sizeable stimulus in place and the Euro-region will contract by 4%. Germany, the world's fourth largest economy and top global exporter, will likely suffer its worst economic performance in its modern history. The UK economy is forecasted to shrink the most since 1946 and Japan is in the midst of a severe and protracted contraction, with exports plummeting by the largest amount in 60 years. In short, the economies of the developed world have ground to a halt and the one-two punch of this extraordinary financial crisis and a deep synchronized global contraction means that a return to sustained, trend growth is possibly years away.

The emerging market economies are mirroring this phenomenon. China, now the world's third largest economy and along with the U.S. one of the key drivers of growth during the recent expansion, is experiencing economic challenges not seen since the Asia Financial crisis a decade ago. China's growth has slowed from a blistering 13% pace in 2007 to a relatively languid 7% this year, and China is regarded as one of the top global performers. Asia region-wide is suffering, disproving the oft-repeated mantra of the past few years that the region had “decoupled” from the U.S., insulating it from possible weaknesses and shocks from outside the region. For example, Korea's fourth quarter 2008 GDP growth collapsed a staggering -21 percent (annualized quarter over quarter), and Singapore an equally stunning -17 percent, the biggest drop on record. Further, India will likely suffer a growth rate this year that's at best just half the pace of last year. Finally, growth will actually decline in Central and Eastern Europe, Central Asia and Latin America and Caribbean.

The world's principal commodities producers, who just a year ago were in an enviable position of benefiting from stratospheric price levels, have been whipsawed by a freefall in prices. With oil prices plummeting by roughly \$100 a barrel, from a record \$147 in July of 2008, and despite a recent recovery, the oil producers are under financial and fiscal stress. Russia experienced a substantial outflow of capital, a collapsing Ruble, a sizable loss of official reserves and a large swing in its external position from positive to negative. The GCC economies are facing the toughest conditions in decades with many of the economies suffering budget deficits and slumping activity. The non-oil commodities producers, such

as copper exporters Chile and Zambia and iron ore producers Brazil and Australia are also experiencing weak demand and flat exports.

The credit crunch is slamming the already highly weakened emerging market economies (EMs). During the 2002 to 2008 expansion, emerging markets boomed, experiencing a solid average annual growth rate of 7%. During this time, many implemented sound policies, such as reducing deficits, reducing foreign exchange denominated debt, accumulating reserves and moving to flexible exchange rates. Such policies and good economic performance created a fertile environment to attract capital, and many of the EMs did attract capital, especially the corporate sector. JP Morgan notes that emerging market corporates borrowed (direct and syndicated lending) over \$1.3 trillion for the three year period of 2006 -2008. These corporate borrowers will need to rollover roughly tens of billions dollars of debt during this current calendar year, which will prove incredibly difficult to accomplish.

In addition to portfolio flows, Emerging Markets and developing economies are also suffering from a drop off in foreign direct investment. The World Bank, in its latest Global Development Finance Report, predicts that FDI into the developing economies will slump by a whopping \$180 billion or 31% in 2009, following on a 10% decline last year. Given that FDI accounts for 40% of total flows to the developing world, such a substantial decline will further depress growth and weigh on the value of EM currencies.

### **The Impact on Low-Income Countries**

Even during the recent boom years, extreme poverty was prevalent in the low-income countries. More than a billion people live on a less than a dollar a day. More than three-quarters of a billion are malnourished -- about a fifth of them children. In fact, every day 25,000 children die from a variety of maladies, many of which are preventable, and some estimate that the current crisis will increase childhood deaths by 200,000 to 400,000 this year alone and hundreds of thousands more over the next few years.

According to the World Bank almost 40% of the 107 developing countries are highly exposed to the crisis and the rest are modestly exposed. It's not just the loss of export markets, the sharp drop in capital flows and collapsing commodity prices, but many low-income countries will *also* suffer from a loss of critical remittances (\$300 billion to \$400 billion annually) and foreign assistance, which will fall in volume and as a share of GDP. Further, the IMF estimates that an adverse balance of payments shock for 38 low-income countries will amount to about \$165 billion but under a "worse case" scenario could hit \$216 billion. All these factors will slash developing countries' growth to just 2.1% this year, a three percentage point decline from last year and will hit some regions very hard. For example, economic growth in Africa this year will plummet to just a third of pre-crisis estimates (2.1% versus 6.4%), likely producing devastating and long-term consequences for the continent. The impact is expected to even prove more devastating in the 35 countries classified as "fragile states" by the World Bank -- 25 of which are in Africa.

The human impact will be painful. As many as 55 to 90 million people will be trapped in extreme poverty this year alone as economic conditions slow, this is on top of the 150 million people pushed into poverty because of soaring food and fuel prices. The number of chronically hungry people is expected to climb to over 1 billion this year. These trends will place an enormous strain on

development organizations and budgets and make it all the more difficult to meet the Millennium Development Goals of overcoming poverty by 2015.

### **The Global Community Responds**

The world's policymakers have responded with imagination and alacrity, implementing policies well outside the conventional textbook suggested options and instruments. Central banks have slashed interest rates to historic levels and moved to employ their balance sheets in ways and magnitudes unimaginable just a year ago in an effort to re-liquefy financial markets, unfreeze credit channels and address concerns of financial counter-party risk. The world's principal central bankers should be applauded for these efforts and for their willingness to undertake extraordinary action to combat this crisis. Officials worldwide have also turned to fiscal policy, with most of the major economies having enacted or currently enacting sizable spending and tax cut programs. Additional fiscal stimulus focused on domestic consumption would be most welcome and should occur in those countries with large or growing savings rates and moderate to low debt to GDP levels (i.e., those with the capacity to enlarge their deficits).

Leaders from the G-20 economies gathered for the second time in just six months in London on April 2<sup>nd</sup> amidst "the greatest challenge to the world economy in modern times" and collectively endorsed the actions taken by monetary and fiscal authorities. Specifically, the G-20 leaders agreed to restore confidence, growth and jobs; repair the financial system and restore lending; strengthen financial regulation; promote global trade and reject protectionism; build a green and sustainable recovery; and, fund and reform our international financial institutions to overcome this crisis and prevent future ones. All of these efforts, working in concert with bilateral programs, other multilateral efforts and NGOs, will help minimize the negative impact of this crisis. Central to this effort, though, is a newly energized, sufficiently resourced, more relevant and legitimate International Monetary Fund.

### **A Revamped IMF Responds**

This crisis has thrust the International Monetary Fund back into a central and prominent role of promoting macroeconomic stability among its member states. The Fund responded quickly and comprehensively, creating a new program to insure good performers against liquidity short-falls and over-hauling many long-established, conventional programs to meet the needs of this crisis and to respond to criticism of past actions. More specifically, the IMF created a new Flexible Line of Credit (FCL) for countries that pre-qualify via a rigorous set of criteria centered on strong fundamentals, policies and track records of implementation. Thus far, Poland (\$20.6b), Mexico (\$47b) and Columbia (\$10.5b) have been approved for the FCL and several other good performers are likely in the pipeline for future approval.

The Fund also enhanced its traditional Stand-by Arrangements (SBA) for members who may not qualify for the FCL, doubling access limits and simplifying cost and maturity structures. Over the past several months, the Fund has extended tens of billions in financing to such countries as Pakistan (\$7.6b), Hungary (\$15.7b), Ukraine (\$16.4b), Iceland (\$2.1b) and Latvia (\$2.34b) to stabilize their fragile economies and minimize possible social strife and political instability.

The Fund is also responding to the plight of low-income countries with three tools: lending, technical assistance and surveillance. The Fund provides concessional financial assistance for countries experiencing protracted balance of payments problems through the Poverty Reduction and Growth Facility (PRGF) and, for temporary needs, through the Exogenous Shocks Facility (ESF). The IMF has approved a doubling of access limits under these facilities and, as of late last year, 78 low-income countries were eligible for PRGF assistance. Further, the IMF doubled concessional financing to low-income countries over the past year through 23 new financing arrangements and via 12 existing ones. New Fund lending to Sub-Saharan Africa has topped \$1.5 billion. The Fund is committed to tripling concessional financing over the next two years, totaling \$6 billion, along with \$19 billion allocated with the issuance of the \$250 billion of Special Drawing Rights.

The Fund also provides assistance for post-conflict countries and emergency relief for natural disasters. Some countries are eligible for the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI). As a result some 37 low-income countries have experienced over \$115 billion of debt relief, with the vast majority of this relief occurring in sub-Saharan Africa. The Fund is also streamlining conditionality to focus on core objectives and to preserve or increase necessary social and safety-net programs. Further, the IMF provides assistance and training to help member countries strengthen the capacity of their institutions and officials to manage their economic and financial policies. The Policy Support Instrument (PSI) provides a path for graduation from serial borrowing programs while offering the policy advice that some countries need. Finally, the IMF also provides a surveillance function to help countries establish economic frameworks that support sustained high growth and poverty reduction, help countries identify and manage risks and vulnerabilities and strengthen institutions and policies that underpin sound macroeconomic management.

To ensure that the Fund has the sufficient resources to meet the needs of this crisis, the G-20 pledged to triple resources available to the Fund to \$750b via \$500b in direct or contingent funding and a \$250b increase in Special Drawing Rights (SDRs). These resources, along with the revamped, more relevant program profile of the Fund, are two key components to ensuring the Fund's success and therefore the stability of the global economy. The third component is to ensure that the Fund has the legitimacy to act on behalf of the global community. To achieve this, the Fund's governing structure needs to change to reflect the changes that have occurred in the global economy. Namely, the EM's need greater voice.

The IMF reform process actually began well before the onset of this crisis. In the spring of 2008 the IMF shareholders agreed to a comprehensive reform package. The Bush Administration submitted this package to the Congress in November of last year. The package includes such changes as a quota increase of \$7.5 billion, re-balancing of voting rights, and flexibility in how the Fund manages its investment portfolio and proposes a sale of a small percentage (about 12.9 million ounces or \$11.6 billion) of its gold holdings. The Obama Administration is proposing to modify this proposal consistent with the G-20 agreement, namely by expanding the Fund's contingent credit line via the New Arrangement to Borrow (NAB) from \$50 billion by up to \$500 billion, of which the U.S. would contribute \$100 billion, and by expanding the NAB membership. The current Administration also proposes providing additional support for the poorest countries and an amendment to permit a special one-time allocation of Special Drawing Rights (\$250 billion) to increase global liquidity and financial stability. I would urge the Congress to approve this package – a product of the current and previous Administration – as soon as possible to ensure that the IMF has the *legitimacy, stature* and *resources* to serve its critical role in global macro-economic stability.

Even with Congressional approval and the extensive changes to Fund programs and focus, the IMF will have to remain nimble, innovative and flexible to changing conditions. It will also need to ensure that it does not sow the seeds of future problems by excessive lending that is beyond what countries need or have the capacity to service. Over the last few years, the Fund has made progress in overcoming unhealthy reliance on lending and “prolonged” support for low-income economies. It’s important that low-income countries maintain a sustainable debt profile and avoid returning to serial IMF programs and re-accumulation of debt to the Fund or other creditors. Finally, the Fund should stick to its core competencies of fiscal, monetary, financial sector and exchange rate policies and structural reforms directly relevant to macro-economic stability. With every organization there is mission creep, but the Fund should continue to resist the temptation to expand beyond its core competencies.

The IMF will also have to address several significant and complex policy challenges in the concluding stages of this crisis and the accompanying withdrawal of global monetary and fiscal stimulus. This includes: the optimal mix between monetary and fiscal stimulus withdrawal, coordination on the same among the key economies, reducing East Asia and core Europe’s reliance on exports, reducing large and persistent external imbalances and addressing exchange rate policy where half the world is pegged to the dollar and half is not.

### **The World Bank Responds as well**

The World Bank is also responding to this crisis, calling on developing countries to pledge 0.7% of their stimulus packages to a global vulnerability fund to help the developing world. The Bank Group has also set up a new facility to speed \$2 billion from the IDA 15 Fund to help the poorest. The main priorities are: safety net programs to protect the most vulnerable; maintain investments in infrastructure (\$55 billion); bolster distressed banking systems; fund agriculture programs (\$12 billion) to ensure food security and safety; and, support for SMEs and microfinance. The Bank Group via the International Finance Corporation is doubling its Global Trade Finance Program to \$2 billion over three years and a putting in place a new Global Trade Liquidity Program (GTLP) to mobilize \$5 billion to support \$50 billion in trade over a three year period. A new \$500 million Microfinance Enhancement Facility will provide refinancing to microfinance institutions in up to 40 of the World’s poorest countries, reaching 60 million low-income borrowers. Finally, the Bank plans to use the IBRD’s balance sheet to increase lending by up to \$100 billion over the next three years.

### **The Principles behind the Washington Consensus are worth Saving**

While the Washington Consensus label or brand has been so maligned that it’s beyond repair, the underlying concepts or principles of the Washington Consensus are worthy of our continued support. The concept and name of the Washington Consensus first originated a decade ago by economist John Williamson to describe the general advice emanating from the IMF, World Bank and U.S. Treasury Department at that time. This advice included fiscal discipline; redirection of public spending towards pro-growth, pro-poor services and programs; tax reform; market determined interest rates; competitive exchange rates; trade and FDI liberalization; privatization of state-run enterprises;

deregulation except that justified for safety, environmental and consumer protection and consistent with prudent oversight of financial institutions; and, protection of property rights.

Both adherents and detractors should be cautious and refrain from zealously employing these principles in an overly rigid, orthodox and ideological manner. They are neither all inclusive nor sufficient for success. They are simply directionally smart policies to achieve macro-economic stability and to remove distortions in an effort to achieve a more efficient allocation of resources. Unfortunately, the current financial and economic crisis has created an opportunity for detractors to renew their criticism, declaring once and for all its demise. But, these policy concepts did not cause the current crisis and may have proven instrumental in insulating many emerging markets from suffering a more acute impact. In fact, the lack of fiscal discipline, exchange rate flexibility and prudent financial oversight contributed to the crisis. The key now is to move beyond the label, learn from the current crisis and fashion a new consensus that countries can use as a guide to achieve maximum sustainable and stable growth and prosperity that is shared widely within an economy while ensuring that the most vulnerable are protected.

### **Why the U.S. should support the G-20 and Multilateral Institutions Response**

I strongly endorse the policy agenda and changes that the G-20 has proposed and are implementing and would strongly urge this Committee and the Congress generally to support them as well. The reasons are numerous. A few are as follows:

**Help countries that help themselves.** The US should champion developing countries' pursuit of sound macro-economic policies, governance and social reforms that are drivers of economic growth and prosperity. These efforts are now at risk due to the events outside their own making and control. We should reward and re-enforce good, responsible behavior and help insure against unforeseen events and systematic failures.

**Fragile nations present a significant threat to US security.** Failed states and extreme poverty breed unrest and instability and create the types of conditions that allow dictators, extremists and terrorist to thrive. In short, it is in our national security interest to ensure that financial and economic crises don't destabilize fragile states, which might prompt either internal or external forces, possibly hostile to U.S. interests, to attempt to gain power and influence. Many of the recent recipients of IMF support (e.g., Mexico, Colombia, Poland, Ukraine, and Pakistan) are key allies and/or critical actors in the success of achieving our foreign policy and national security objectives.

**US prosperity is intertwined with developing nations.** We live and work in the most integrated, globalized economy in human history. As we have learned during this crisis, events – disruptions -- in one part of the system can quickly impact other parts, often in a cascading fashion, and the oft-touted concept of “de-coupling” has now been discredited. Furthermore, the future of the U.S. economy will increasingly depend on the developing world. Since 2004, U.S. exports to developing/emerging market economies have grown 60%, which is three times the pace to the more mature markets in the developed economies. Also, 95% of the world's population – all potential consumers of our goods and services -- reside outside the U.S and 98% of population growth between now and mid-century will occur in the developing regions. Finally, according to the IMF, non-advanced economies will account for 70% of economic growth over the next five years. In short, the future of U.S. economic growth and

prosperity is dependent on economic growth and stability outside our borders, and increasingly dependent on emerging and developing economies.

**Reward institutional reforms.** The IMF has undertaken the most sweeping reforms in over a quarter century -- maybe since its inception -- in an effort to adapt to the changes that have occurred in the global economy and financial markets. The Fund's new and revamped programs are much more relevant to the way in which the global economy functions and are designed to address specific markets and challenges, including low-income countries. The Fund now needs the resources to ensure that these programs are sufficiently funded to weather this and future financial and economic crises with minimal damage to the global economy and the most vulnerable. The Fund, working with the G-20 and key shareholders, is also attempting to revamp its governing structure to also reflect the changes that have occurred in the global economy. Giving emerging market and developing economies representation and voice commensurate with their role in global economic activity will give the IMF the legitimacy it needs to strengthen its surveillance role and to address critical policy issues, such as a foreign exchange misalignment and reserve accumulation.

**US leadership and responsibility at an historic time.** The global community is watching closely to detect a U.S. hesitancy or lack of will to lead through the crisis. The descent of U.S. power, authority, values and influence is an oft-discussed, much-written-about topic these days. This is especially true given that the crisis originated in the U.S. and is in no small measure a product of U.S. policies, behaviors and regulatory failures. Other countries have added to and exacerbated this crisis but we bear the brunt of responsibility. If we fail to lead, if we turn inward as we have at other times in history, others will seek to exploit this and fill the perceived vacuum, likely with policies, principles and ideals different and potentially hostile to the U.S. It is our duty to lead and in our interest to do so.

## **Conclusion**

We are in the midst of the most extraordinary economic challenge of our times where no part of the global economy -- from Norway to Nigeria to New Zealand -- is immune. The G-20 has laid out a sound, comprehensive response to stabilize economic and financial conditions, quickly restore growth and ensure that this kind of crisis does not occur again. We must also ensure that the world's poor and most vulnerable do not suffer greatly in this crisis. I strongly endorse the G-20 effort, including specific proposals centered on support for and reform of the International Monetary Fund. Macroeconomic stability is a necessary component to the G-20 achieving its stated objectives. Further, mounting budget deficits and overwhelming domestic priorities will likely strain our and the developed world's capacity to meet, let alone exceed, development assistance pledges. This is no time to short-change our commitments. I support the President's proposed increase of foreign and development assistance funding and I urge the Congress to do so as well.

