Progress on the "Global Deal": International Cooperation Works

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With a little distance from the hype of the two important global events of April—the G-20 London Summit and the spring meetings of the IMF and World Bank—it is perhaps easier to judge how effective these jamborees have been in addressing the key challenges of the current financial and economic crisis. Our assessment is that a "global deal" has been struck and that it is one which deserves to be taken seriously.

The message of the G-20 London Summit had four pillars: robust, comprehensive fiscal responses by all G-20 countries, specific regulatory and institutional innovations in asserting public responsibility over financial markets, major additional resources for the IMF to restore it to its role as the steward of the global financial system, and significant new efforts and resources for lower income developing countries. Action on these four pillars constitutes the "global deal" Gordon Brown was looking for and could provide "the turning point" Barack Obama and the world is hoping for.

What progress do we see so far?

The most ignored significant sentence in the communiqué of the G-20 London Summit is "we are undertaking *an unprecedented and concerted fiscal expansion* . . . that will, by the end of next year, amount to $5 trillion." To ignore the accomplishment contained in this sentence is to deny that the G-20 summit process itself, launched last October, has generated peer pressure for a robust fiscal-policy response, broadly construed, by most G-20 countries which now amounts to almost 5 percent of G-20 GDP. The Chinese led off just before the first G-20 summit in Washington in mid-November with a $585 billion stimulus package. Even before taking office, the Obama administration proposed a massive stimulus that was passed by Congress a month ago at $787 billion. Other countries followed suit with Australia, Germany, Korea, Russia, Saudi Arabia, and South Africa adopting discretionary spending or revenue reduction measures greater than 1 percent of their GDP.

The hidden story in the robust fiscal responses of G-20 countries has been the role that social safety net spending programs have had in many countries. The rift over the supposedly lackluster fiscal response in Europe as compared to the U.S. ignored the incremental public expenditures that are triggered by the economic downturn and constitute effective remedies to it. To the person in the street, there is no difference between receiving a tax rebate check and receiving an unemployment compensation check. Both add to global demand. In the run-up to the London G-20 Summit, only the tax rebate check counted as a "discretionary" fiscal stimulus. The social safety net expenditures were ignored, even though they have the *same economic* effect as a tax cut or an incremental public investment expenditure.

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Twelve G-20 countries have estimated automatic social expenditures over the next two years of 1 percent of GDP or more, and for five G-20 countries, the estimates exceed 2 percent of GDP. If these social expenditures are counted along with discretionary fiscal actions for all G-20 countries, they amount to an average of 2.6 percent of G-20 GDP over the next two years, or about $2.5 trillion dollars. The combined social and fiscal expenditures of the four European members of the G-20 (the UK, France, Germany, and Italy) for the next two years amount to 2.8 percent of their GDP, higher than the G-20 average. So, the rift was not real, in economic terms.

Not only was there no real rift between the United States and Europe on the fiscal front taken as a whole, but the G-20 as a whole managed to exceed the IMF benchmark of 2 percent of GDP as the target for fiscal policy response, if social expenditures are included as they should be.

Hence, if public expenditures for social programs as well as for the recapitalization of banks, the rescue of non-banks and insurance companies, and the bail out of systemically significant firms are taken into account, as they should be, then there has been a massive fiscal effort of $5 trillion by the G-20 countries as we look ahead to the next two years.

This constitutes a historically unprecedented "concerted fiscal expansion" in scope and scale; never have so many countries acted together to give such a combined jolt to world economic growth as the G-20 countries have cumulatively undertaken since last fall. Their comprehensive actions taken together over the last seven months amount to 5 percent of G-20 GDP, which represents more than 80 percent of the world economy.

Now, if the $5 trillion in cumulative stimulus commitments are combined with the other actions taken at the first two G-20 Summits, then there clearly is a "global deal" that has been struck by the G-20 countries through the summit process. One trillion dollars vault the IMF from the margins of the global financial system back into a central role in it, especially if its governance is reformed substantially, as promised. The specific actions taken on financial oversight, supervision, and regulation and the new mandate given to the newly named and transformed Financial Stability Board with a dozen new G-20 members will accelerate progress on domestic institutional innovation to strengthen vigilance over financial markets and practices as well as oversee, with the IMF, the global spillover effects of financial activities. And, finally, the actions on trade finance, IMF gold sales for low-income countries, SDR allocations, and additional aid commitments will provide developing countries with a cushion of over $100 billion. These actions together constitute massive, multiple efforts to address the crisis.

At the IMF/World Bank Spring Meetings on April 25–26, progress was made by ministers to rapidly marshall $500 billion in additional resources for the IMF through pledges and bond purchases by major countries and to go forward with a $250 billion SDR allocation, bringing the IMF total resources to $1 trillion—enough to be a credible force in the global financial system once again.

Much will depend on how the commitments will be implemented. But progress is being made. International cooperation is the hallmark of that progress. Naysayers may yet have their day, but not for now.