

Richard Lambert: G20 must restore the stability of the world's financial system

Richard Lambert

Since the G20 meeting in Washington four months ago, the already bleak outlook for the world economy has deteriorated significantly. The International Monetary Fund (IMF) has revised its November forecast for global growth this year down by 1.75 percentage points to only 0.5 per cent. Global trade has plummeted, and so have private capital flows to the emerging economies. The Institute of International Finance puts the figure for this year at only \$165 billion, compared with \$929 billion in the peak year of 2007.

So business people around the world are looking to the London meeting of the G20 on April 2 with a real sense of urgency. Leaders representing countries with 85 per cent of global output will be sitting round the table. Rather than coming up with a series of general platitudes covering a wide range of issues, it is vital that they focus instead on a small number of action points, all concentrated on one overriding objective: the need to put a brake on what the IMF has called the "pernicious feedback loop" between the real economy and financial markets.

What this means is that continued crisis in the financial system is causing asset prices to fall and the cost of capital to rise. This is having a serious impact on consumer and business confidence everywhere in the world, which in turn is reducing demand for consumer and capital goods. As the economy slows, credit risks grow, injecting further uncertainty into the financial system.

So task No1 for the meeting next month is to do whatever it takes to restore the stability of the world's financial system. Although each nation's problems are different, governments must agree on common approaches to fixing them. Otherwise, as Ireland showed, unilateral efforts to prop up one country's banks can have adverse impacts on another's.

The next step is to push back hard against the worldwide collapse in the demand for goods and services. The United States has committed to a stimulus equivalent to 5.5 per cent of GDP: other countries that have the capacity to follow must do so. The surplus countries have the heaviest responsibility — and the most urgent need — to act. China is on the way; Japan and Germany have more to do.

A growing number of countries are going to need external help, and the international community has a strong interest in providing it. Obvious examples are in Central and Eastern Europe, where increasing economic and political stress points have the capacity to put serious strains on the European Union and beyond. They are going to need far more help than has been promised so far. This will require new thinking by all the multilateral development banks. But the urgent priority has to be reforms in the IMF, both to provide the fund with the resources that it needs to deal with these multiplying problems and to give greater prominence to the emerging economies in its governance structures. Its lending capacity needs to be very substantially increased and the big countries of the West are going to have to vacate some space at the boardroom table.

The G20 communiqué of November was long on promise but short on detail when it came to the vital question of free trade and open markets. The commitment to make a decisive breakthrough on the Doha Development Agenda by the year end has delivered nothing. And some of the same G20 leaders who were then emphasising the critical importance of rejecting protectionism have since moved in the opposite direction, with subtle and not-so-subtle tariff increases, subsidies for troubled industries, exchange rate interventions and bank bailouts designed to favour the home market. So, decisions taken in London will have to be much more crunchy if they are to be taken seriously. And transparent mechanisms will be required to monitor commitments and highlight abuses.

Globalisation has helped to lift 500 million people out of poverty in the past 15 years. But the present crisis could push 90 million back down the ladder to extreme poverty. For economic as well as social reasons, the rich countries cannot afford to ignore this threat. They must show that they are honouring their promises to increase development assistance and prove they mean business with the Millennium Development Goals, especially when it comes to poverty alleviation.

The London summit should not allow itself to get bogged down in the detail of financial re-regulation. That would be a sure way to stymie progress. Instead, it should assess the programme that was set out in Washington and adjust it where necessary.

Transparency and independence are essential. If, for example, the IMF is going to be given greater responsibility for identifying stress points in the global economy, it will have to be free to criticise its main shareholder, the US, when appropriate. Otherwise, this will be a worthless exercise.

What is essential: co-ordinated efforts to rebuild financial stability and to check the fall in global demand; support for much increased resources and governance reforms for the multilateral institutions; practical steps to push back the growing forces of protectionism and to complete the trade round; progress along the path of reform in the international financial markets.

These are big asks. They will require political leadership of the highest order, above all, from President Obama. But if the G20 can rise to the challenge next month, it will represent an important step in restoring the confidence that is so badly needed by businesses and consumers everywhere.