Developing Countries and the Global Crisis
by Joseph E. Stiglitz, April 2009

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NEW YORK – This year is likely to be the worst for the global economy since World War II, with the World Bank estimating a decline of up to 2%. Even developing countries that did everything right – and had far better macroeconomic and regulatory policies than the United States did – are feeling the impact. Largely as a result of a precipitous fall in exports, China is likely to continue to grow, but at a much slower pace than the 11-12% annual growth of recent years. Unless something is done, the crisis will throw as many as 200 million additional people into poverty.

This global crisis requires a global response, but, unfortunately, responsibility for responding remains at the national level. Each country will try to design its stimulus package to maximize the impact on its own citizens – not the global impact. In assessing the size of the stimulus, countries will balance the cost to their *own* budgets with the benefits in terms of increased growth and employment for their own economies. Since some of the benefit (much of it in the case of small, open economies) will accrue to others, stimulus packages are likely to be smaller and more poorly designed than they otherwise would be, which is why a globally coordinated stimulus package is needed.

This is one of several important messages to emerge from a United Nations Experts Commission on the global economic crisis, which I chair – and which recently submitted its preliminary report to the UN.

The report supports many of the G-20 initiatives, but it urges stronger measures focused on developing countries. For instance, while it is recognized that almost all countries need to undertake stimulus measures (we’re all Keynesians now), many developing countries do not have the resources to do so. Nor do existing international lending institutions.

But if we are to avoid winding up in another debt crisis, some, perhaps much, of the money will have to be given in grants. And, in the past, assistance has been accompanied by extensive “conditions,” some of which enforced contractionary monetary and fiscal policies – just the opposite of what is needed now – and imposed financial deregulation, which was among the root causes of the crisis.

In many parts of the world, there is a strong stigma associated with going to the International Monetary Fund, for obvious reasons. And there is dissatisfaction not just from borrowers, but also from potential suppliers of funds. The sources of liquid funds today are in Asia and the Middle East, but why should these countries contribute money to organizations in which their voice is limited and which have often pushed policies that are antithetical to their values and beliefs?

Many of the governance reforms proposed for the IMF and the World Bank – affecting, most obviously, how their heads are chosen – finally seem to be on the table. But the reform process is slow, and the crisis will not wait. It is thus imperative that assistance be provided through a variety of channels, in addition to, or instead of, the IMF, including regional institutions. New lending facilities could be created, with governance structures more consonant with the twenty-first century. If this could be done quickly (which I think it could), such facilities could be an important channel for disbursing funds.

At their November 2008 summit the G-20 leaders strongly condemned protectionism and committed themselves not to engage in it. Unfortunately, a World Bank study notes that 17 of the 20 countries have actually undertaken new protectionist measures, most notably the US with the “buy American” provision included in its stimulus package.

But it has long been recognized that subsidies can be just as destructive as tariffs – and even less fair, since rich countries can better afford them. If there was ever a level playing field in the global economy, it no longer exists: the massive subsidies and bailouts provided by the US have changed everything, perhaps irreversibly.

Indeed, even firms in advanced industrial countries that have not received a subsidy are at an unfair advantage. They can undertake risks that others cannot, knowing that if they fail, they may be bailed out. While one can understand the domestic political imperatives that have led to subsidies and guarantees, developed countries need to recognize the global consequences, and provide compensatory assistance to developing countries.

One of the more important medium-term initiatives urged by the UN Commission is the creation of a global economic coordinating council, which would not only coordinate economic policy, but would also assess impending problems and institutional gaps. As the downturn deepens, several countries may, for example, face bankruptcy. But we still do not have an adequate framework for dealing with such problems.

And the US dollar reserve-currency system – the backbone of the current global financial system – is fraying. China has expressed concerns, and the head of its central bank has joined the UN Commission in calling for a new global reserve system. The UN Commission argues that addressing this old issue – raised more than 75 years ago by Keynes – is essential if we are to have a robust and stable recovery.

Such reforms will not occur overnight. But they will not occur *ever* unless work on them is begun now.