



The Trillion Dollar Plan

The rapidly unfolding global financial and economic crisis will severely disrupt economic growth worldwide, affect the livelihoods of billions around the world and endanger progress toward the poverty reduction and other millennium development goals (MDGs).

Major industrialized countries and some developing countries have put together massive financial sector rescue packages and large fiscal stimulus packages. Since the outbreak of the crisis up to March 2009, the total support is estimated at a staggering \$20.8 trillion or 33.5 per cent of the estimated World Gross Product (WGP) for 2008. The vast majority of these resources comprise government guarantees of toxic assets held by the banking sectors in the United States, Europe and elsewhere. The fiscal stimulus plans total about \$2.6 trillion or 4 per cent of WGP to be spent, roughly, over the three-year period between 2009 and 2011. Many observers, including analysts at the IMF and the United Nations, consider this amount of fiscal stimulus to be insufficient.

Developing countries are particularly exposed to this crisis. They have less resilient economies and with fewer resources they are more typically forced to pursue pro-cyclical monetary and fiscal policies, imposing greater variability in their economic performance to the detriment of long-term growth.

Global responses should urgently redress this asymmetry. In the first place, this would require providing sufficient financial resources to developing countries to engage in counter-cyclical measures. If spent effectively, this could not only put the global economy on a more sustainable growth path but also help to meet poverty targets and development goals set by the international community.

For this, the United Nations has estimated that developing countries would need around \$1 trillion for 2009 and 2010, half of which would be used for covering short-term financing needs, with the other half required for long-term development lending and assistance. While this seems like large sum of money, it can be feasibly delivered through existing mechanisms and within existing commitments. Moreover, it would send a strong signal of solidarity to developing countries that they will be supported through the crisis.

Meeting short-term liquidity needs (\$500 billion)

According to the World Bank and the Institute for International Finance, private capital flows to developing countries declined by about \$500 billion in 2008 from 2007 levels and a further decline by about \$630 billion is forecast for 2009. The decline has been the result of, inter alia, a severe squeeze of trade credits,

which is affecting trade and growth of developing countries directly. Well over \$1 trillion in corporate, external debt in emerging markets and other developing countries will mature in 2009 and will need to be rolled over. As commodity prices and exports decline and income from worker remittances subsides, most developing countries will experience severe balance of payment problems.

The World Bank estimates that 98 of 104 developing countries are expected to fall short of covering external financing needs, with an estimated gap which could be as high as \$700 billion. For low-income countries alone, the IMF estimates that the balance-of-payments shock could amount to \$140 billion in 2009.

While some developing countries have accumulated vast amounts of international reserves, these are unequally distributed (most held by China) and insufficient for most developing countries to cope with the magnitude of the external shock provoked by this crisis.

How to mobilize the increase in compensatory financing?

The additional resources for compensatory financing could be mobilized through issuance of special drawing rights (SDRs), unused special borrowing facilities of the IMF and through the mobilization of reserves and resources accumulated in sovereign wealth funds from surplus countries.

The G20 already seems to have neared an agreement on doubling (as proposed by the EU) or tripling (proposed by the United States) the IMF's existing lending capacity of \$250 billion. New SDR issuance could amount to \$250 billion as has been proposed in the past, but failed to gain the backing of the United States government. Now this seems more acceptable. The Japanese government has already lent \$100 billion of its reserves to increase the IMF's lending capacity. Countries with vast amounts of reserves, such as China or some of the major oil exporters, could contribute similarly, though this likely will require making sufficient progress towards governance reform of the IMF to make this politically more acceptable for these countries. Mobilizing resources through regional reserve funds should also be considered. For instance, Asian countries have already agreed to increase resources for liquidity provisioning through the Chiang Mai Initiative, their main mechanism of regional financial cooperation. Both international (IMF) and regional channels should be used, requiring closer collaboration between the IMF and regional institutions of financial cooperation.

What about conditionality?

Adequate oversight of the usage of resources will also need to be

established, ensuring in particular that the compensatory financing is not subject to the kind of pro-cyclical policy conditionality which is typically attached to existing mechanisms.

Financing needs for fiscal stimulus (\$500 billion)

In addition, another \$500 billion in enhanced long-term official financing will be needed to cover fiscal revenue gaps in 2009 and 2010 (due to falling export revenues and slower growth) and provide developing countries with the necessary resources to protect social spending and finance fiscal stimulus packages. Spread over two years, these resources would provide the means for a stimulus of about 3 per cent *per year* of the combined GDP of developing countries (excluding China and major oil-exporting countries), which—assuming a multiplier effect of about 1.7 from well-designed and internationally coordinated fiscal packages—would support adequate growth recovery.

Half of the required resources could be mobilized by enhancing the lending capacity of multilateral development banks and the remainder through increased official development assistance through accelerated delivery on existing donor commitments.

How to finance \$250 billion for increased development lending?

The increase in development lending could be mobilized through the multilateral development banks. This could be achieved as follows:

- By optimizing use of available capital, the World Bank could make new development financing commitments for about \$100 billion.
- With a \$60 billion replenishment of their capital and maintaining solid leverage ratios, regional development banks could expand development lending by about \$150 billion.

This should be feasible. The World Bank would be using existing lending space and has already announced increased lending capacity in this way. The Asian Development Bank has already requested a replenishment of its capital. Surplus countries with vast amounts of reserves and sovereign wealth funds could similarly allocate some of its resources to regional development banks in order to expand their lending capacity.

How to mobilize and additional \$250 billion in official development assistance for the poorest countries?

The increase in ODA could be mobilized as follows:

- *\$50 billion* could be mobilized by front-loading resources in the already replenished International Development Assistance (IDA) window of the World Bank and those in the concessional windows of the regional development banks.
- *\$200 billion* would need to be mobilized through an acceleration of the delivery on existing ODA commitments.

The required resources can be provided on the basis of available resources and existing commitments. The World Bank's

concessional window (IDA) was already replenished by \$30 billion in 2008 to cover three years of credits and grants. This could be frontloaded to make these resources available during 2009 and 2010. Equally concessional lending windows of regional development banks (ADB, AfDB, IDB and others) could be frontloaded to provide the additional \$20 billion.

Donors have repeatedly pledged to deliver on existing aid commitments, including at the Doha Follow-up Conference on Financing for Development of November-December 2008. At the 2005 Gleneagles Summit, the G8 committed to raise ODA to at least \$160 billion per year (at 2008 prices) by 2010¹ (up from \$103.7 billion in 2007). Meeting this commitment should increase existing aid flows by a total of about \$115 billion over 2009-2010. Further delivery towards the agreed UN target of 0.7 per cent of their annual GNI could provide the remaining \$85 billion needed over 2009-2010, which would bring ODA to about 0.4 per cent of GNI of OECD/DAC members.

The World Bank's proposal for a "Vulnerability Fund" of the size of 0.7 per cent of the developed countries' stimulus packages (amounting to about \$15 billion) might form a part of this broader proposal.

Which conditions?

Not only the amount of support matters. In the allocation, priority should be given to the most vulnerable developing countries, especially the least developed countries. Also, delivery on the additional ODA resources should follow through on donor commitments of the Paris and Accra declarations to improve aid effectiveness and improving the predictability of aid flows for recipient countries.

It's not all about the money

Meeting these financial needs is essential to avoid major setbacks in growth, job creation, poverty reduction and social development in the emerging economies and developing countries in general. This makes good economic sense as it will facilitate a truly global recovery. But, it is not only about the money, of course. It needs to be spent wisely with an eye on addressing long-term challenges. It also only a part of a solution to a crisis that has revealed systemic flaws in the international financial architecture and mechanisms of global economic governance. These flaws will need to be addressed simultaneously. ■

¹ The G8 committed at the Gleneagles Summit of 2005 to raise aid flows to \$130 billion per year at 2004 exchange rates and prices. At current prices and exchange rates this translates to about \$160 billion.

Prepared by:

Rob Vos, *Director*, Development Policy and Analysis Division
Department of Economic and Social Affairs, Rm. DC2-2020
United Nations, New York, NY 10017, U.S.A.
Tel: +1 212 963-4838 • Fax: +1 212 963-1061
e-mail: vos@un.org • website: <http://www.un.org/esa/policy>