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Stopping a Global Meltdown

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When the finance ministers of the world's top economies convened in Washington last month, around the annual meeting of the International Monetary Fund, they developed a remarkably successful international strategy for responding to the financial crisis, which had reached panic proportions in the markets. It was promptly implemented at the national level by all the key countries and quelled the worst of the anxieties. When the leaders of the top 20 of these countries meet on Saturday, they must build on that outcome by adopting a similarly global approach to counter the sharp downturn in the world economy that could otherwise become the most severe since the Depression.

To do so, the Group of 20 must at a minimum do no harm. Any surfacing of significant conflicts over such contentious issues as internationalization of financial regulation would undermine confidence, which remains extremely fragile, dissipating the hard-won gains to date and throwing markets into a new tailspin. Leaders must, for example, avoid the temptation to agonize over who caused the crisis and recognize that, while the United States was clearly at its center, there is plenty of blame to go around.

The most positive step the leaders could take would be to pledge to adopt fiscal stimulus programs amounting to at least 1 to 2 percent of most of their national economies. Such an injection of domestic demand throughout the G-20 would provide a critical spur to world economic expansion and substantially reduce the depth of the recession. China, which now accounts for more than one-third of all global growth, has demonstrated admirable leadership by announcing an expansion program of much greater magnitude. It is up to the United States and Europe, in particular, to follow suit; an international commitment should help overcome internal opposition to such steps (especially in the United States and Germany).

The G-20 should also disavow the imposition of any new trade distortions. It was a wave of protectionist trade measures, triggered by the infamous Smoot-Hawley tariff in the United States and quickly emulated by most Europeans, that converted the depression of the early 1930s into the Great Depression. China has recently adopted new export subsidies, a particularly unhelpful step by a country running the world's largest trade surplus and, despite its recent slowdown, the world's fastest growth rate. Any new outbreak of border restrictions or their domestic equivalents would threaten growth everywhere and further jeopardize market stability.

The leaders also need to pledge at least $500 billion to augment the resources of the International Monetary Fund so it can meet the potential needs of developing countries hammered by the crisis. The IMF is already lending to Hungary, Iceland, Pakistan and Ukraine, but a longer queue is forming rapidly. Japan has offered $200 billion, and China, with reserves nearing $2 trillion, could provide at least as much. The rich oil exporters, represented by Saudi Arabia at the G-20, could do so as well. The lenders would, of course, receive an IMF guarantee on their money and should welcome this alternative to U.S. Treasury securities.

The final component of the G-20 package should be the creation of working groups to address systemic issues that helped bring on the crisis, most of which require careful analysis and preparation before thoughtful action is feasible. The most obvious is financial regulation, which clearly broke down in the United States and numerous other countries; there is an important international dimension because of the cross-border nature of many financial institutions and market instruments. Another is the failure of the IMF, and its major member countries, to anticipate the crisis and to initiate preventive actions. A closely related third issue is the growing lack of political legitimacy of the IMF thanks to its gross under-representation of rapidly emerging Asian powers and the parallel over-representation, for historical reasons, of Europeans. Thoughtful analysis by the new working groups could tee up these issues for decisive action at future summits and help considerably in avoiding repetitions of today's predicament.

It is difficult for the United States to lead the preparation of such a package, given the lame-duck status of President Bush, who is hosting the summit. It is critical, then, that President-elect Barack Obama concur with the outcomes of the gathering, both to ensure their faithful pursuit in the future and to avoid internal U.S. rancor that could be as destabilizing for markets as conflict among the countries. Effective consultation between the outgoing and incoming administrations is central to the success of the gathering. So is active leadership from the Europeans, who called for the meeting, and the Asians, who have the most dynamic economies and most of the money. History may regard this weekend as the beginning of a transition in global economic power as well as a milestone in resolving the crisis of 2008.

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