SUPPORTING GLOBAL GROWTH

A PRELIMINARY REPORT ON THE RESPONSIVENESS AND ADAPTABILITY OF THE INTERNATIONAL FINANCIAL INSTITUTIONS BY THE CHAIR OF THE LONDON SUMMIT

REPORT BY THE PRIME MINISTER

At its Washington and London Summits, the G20 came together to fight back against the global recession. By coordinated international action, the world stabilised the banks, agreed new regulatory principles, and created contingency funding for emerging markets that faced problems because of the state of global capital markets.

We delivered a concerted fiscal response worth in total 5 per cent of GDP both this year and next, as well as the full array of conventional and unconventional monetary policy measures. Many independent commentators have since said the unprecedented nature of our international co-operation helped avert a significant deepening of the crisis. The US Council of Economic Advisers concluded that for every extra 1 per cent of GDP in discretionary fiscal stimulus, countries grew 2 per cent growth faster.

We must continue to implement our financial support measures and expansionary monetary and fiscal policies until recovery is secured, consistent with price stability and long-term fiscal sustainability. Based on the ILO's analysis, I believe that the fiscal stimulus we have agreed for this year and next will, if fully implemented, save or create around 15 million jobs.

But while we are no longer staring into the abyss of last year, the need for international cooperation is even greater now than it was then. Because we still need to secure the recovery and to find, globally, the path to sustained and balanced growth.

The stakes are high. With strong and successful co-operation the IMF suggests that by 2014 world output could be more than a tenth higher – about $6 trillion – than if we pursue weak or counterproductive policies. That would be the difference between strong growth in jobs, increasing prosperity and poverty reduction on the one hand, and high levels of unemployment and worsening hardship for lower income countries on the other.

The International Financial Institutions and architecture have a crucial role in supporting these goals. As we develop and agree a new, more robust, 21st century approach to governing our international economy, we need international financial institutions with the capacity and effectiveness to support our needs in a world of global capital flows.

That is why we agreed in London to strengthen the relevance, effectiveness and legitimacy of the IFIs to enable them to prevent future crises. As agreed in London, I am reporting back in advance of discussion in Pittsburgh on further reforms to increase the responsiveness and adaptability of the IFIs, to meet the challenges of globalisation. I am grateful for the responses to the wide consultation which has underpinned the formulation of the ideas in this report and look forward to further responses to the ideas in these papers. I hope Leaders can take them forward together.

The key lesson of the crisis is that in an increasingly interconnected global economy we need both stronger economic coordination and more effective international financial institutions and architecture to support this, and a stronger framework of financial regulation, recognising the imperfections and risks in global markets. The technical report sets out the ideas here in more detail.

A global compact for growth and stability

I propose a global compact for growth and stability to secure both the recovery and sustainable and balanced growth over the medium to long term. Above all, this compact must be based on a strong political consensus from G20 countries to co-operate to advance our prosperity, grounded in the recognition that our economies are highly interdependent.
The compact would have three central objectives:

- first, we must make every effort to support the recovery and plan coordinated exit strategies from our current expansionary measures to make sure that the recovery is not put at risk;

- second, we must agree a framework for how each of us over the medium term can best contribute to worldwide growth, including through structural reforms, to benefit jobs in all our countries, and that this growth is balanced and sustainable; and,

- third, we must reform and strengthen the governance of what is now a global financial sector.

This compact should be grounded in the principles and values set out in the proposed Charter for Sustainable Economic Activity.

In the past we have had political statements on the need for measures that require co-operation, but these have not been backed up by robust economic analysis and action. And we have had multilateral surveillance, which has lacked the political decision-making needed to give it traction.

The emergence of the G20 as a central part of our economic governance gives us a historic opportunity to provide real political leadership on the economic policy measures needed to create and sustain growth. In order to deliver this, we need a concrete framework which sets out how our objectives will be set, how we decide on the measures we need to take, and how we will follow up on the results.

We need a new framework under which political Leaders assess together economic policies which may affect each other, with political decision-making by the G20 countries underpinned by the best possible economic expertise and analysis. This should be based on the following essential elements:

- explicit agreement, regularly assessed, by the G20 on our common objectives of balanced, sustainable and enduring growth;

- a commitment by each country to set out its medium-term policy framework, showing how it will contribute to the common objectives;

- analysis provided by the IMF on the situation and risks in the world economy, working together with the Financial Stability Board on the interaction of financial and economic risks, drawing on other institutions as needed. This should include analysis of the consistency of our economic plans with our overall objectives for sustainable and balanced global growth;

- clear mechanisms to warn us when we are off track to deliver our objectives, so that governments can take decisions on the need for action based on the best possible information; and

- political agreement on the policy actions needed to address any risks and problems.

Our Finance Ministers should be tasked with working through the details of this process when they meet next at St Andrews in November, with further development to go forward through the Finance Ministers' process. We should then review the economic situation when we next meet.

But at Pittsburgh I propose we do more than just launch this new process. We should have an agreement now to deliver strong economic co-ordination as we face a period of uncertainty in the recovery, as we look forwards to decisions on the nature and timing of exit strategies, and as we start on the road to securing a more stable balanced and sustainable global economy.

I therefore propose that we launch the compact by agreeing that we are committed to high levels of growth on a sustainable and balanced basis. The IMF estimates that world growth in real terms will resume this year and rise to nearly 3 per cent by the end of 2010, on the way to sustained recovery. As I have noted, they have also reported the higher levels of growth we can obtain by pursuing policies for sustainable and balanced growth. We should commit to put in place the necessary policy measures to achieve these ambitious outcomes. That will require coordinated and consistent policies in all our economies over a number of years, many of them structural reforms.

To support this compact we need to reform the International Financial Institutions to be effective and credible:

- in preventing future crises by shifting their focus from bilateral to systemic issues so that they can provide governments with the best possible advice;
- in combating economic shocks by helping deal with sudden stops in markets for project finance, and making crisis facilities faster acting and more flexible;
- in supporting the needs of the poorest countries; and
- in supporting our global efforts to combat climate change.

As an integral part of these reforms, we need to make the governance of the IMF and World Bank more robust and representative of emerging and low income countries, each reflecting their respective mandates. As the governance of the IMF is reformed we should look to bring the membership and structures of the G20 closer to that of the IMFC.

Preventing future crises

To strengthen the role of our institutions in supporting the compact:

First, we should change the main focus of IMF analysis away from individual countries and towards systemic issues which affect us all, including global and regional surveillance, analysing levels and trends in macroeconomic imbalances, assessing the consequent systemic risks and providing policy recommendations. We need a dedicated multilateral policy department of the Fund to ensure they can adequately address these risks.

Second, we should give the IMF an objective to support financial stability, alongside the Financial Stability Board, to build on the capacity it has developed over the last decade, and ensure it can recognise and give early warning of risks flowing from the financial sector to the real economy.

At the same time, we should strengthen the role of the Financial Stability Board, founded at the London Summit but faced with growing demands. We should strengthen and make independent the resource base of this new institution and make it formally responsible to the G20. We should give the FSB a clear role in ensuring that international standards are developed effectively and within the necessary timeframe and reporting on progress to the G20.

Third, we should look to make the IMF's regular bilateral surveillance activity on specific countries more independent, more credible and more effective, building on the work already achieved. Countries should agree in advance that their Article IV reports should be public and the Fund must be seen to be empowered and equipped to present views independently of political interference, with the Governors holding management accountable for overall delivery.

Combatting economic and financial shocks

In an integrated global economy and with global capital markets, we must ensure that the IFIs have the tools and resources they need to be able to respond and adapt to new challenges.

The $1.1 trillion we committed to at the London Summit gave a massive boost to confidence, especially in emerging markets. In the future, the IFIs need to be able to help countries insure themselves against the risk of future crises.

When they face a shock, such as the capital market shocks recently experienced, countries need to know that they can access finance quickly and on the scale required. In turn, this will reduce the incentive to hold foreign exchange reserves and allow them to be channelled into productive investment.

The World Bank and the MDBs should be recognised for the part they have played in responding to the crisis and supporting world demand. I believe they must do more - making greater use of guarantees and putting mechanisms in place so that when triggered by future crises, they can increase their gearing and maximise the use of their capital.

We must ensure the MDBs are capitalised to meet the future needs of the global economy, including considering general capital increases. But this must be accompanied by rapid progress on strengthening governance and accountability, and increasing operational effectiveness to give shareholders greater confidence that resources provided to and through the Bank will reduce poverty and foster sustainable growth. At the World Bank in particular there is a need for including a significant increase in the voice and representation of emerging and developing countries and especially the poorest. The IMF has made real progress with its new Flexible Credit Line. But more still needs to be done. Assessment for the FCL should be an automatic and systematic part of the process of surveillance of economies. And we need to bring together regional and bilateral arrangements so they can play a role alongside the IMF in the provision of financial support, within a coherent and consistent framework.

Through these measures we should reduce the need for countries to accumulate reserves, freeing up resources to use for productive investment as a source of growth. As part of that we should be encouraging innovative use of financing by sovereign wealth funds and other private investors. I propose that the G20 should also look to the World Bank to support a 'Fund of Funds' mechanism financed and managed by the private sector to attract investment from sovereign wealth funds so that reserves can be invested more efficiently in developing country infrastructure.

Supporting the poorest

The global economic crisis has hit hardest many of the poorest nations of the world, setting back progress towards the Millennium Development Goals. International mechanisms to provide concessional finance flexibly and on the scale required have been found wanting.

Since London steps, have been taken to remedy this but more still needs to be done to provide much needed finance to help low income countries and support the growth and poverty reduction programmes that have been hard hit by the global downturn. I welcome the Fund's work in drawing up proposals to mobilise existing SDR resources for the poorest countries. We should urge all countries that have the resources to lend a proportion of their SDRs to ensure the IMF has the capital resources it needs to support lending to low income countries.

But I propose that we should agree to go much further with the urgent creation of a new crisis response facility at the World Bank to provide additional emergency funding to low income countries on IDA terms, financed through a mix of IBRD and donor contributions.

Addressing the challenge of climate change

A global agreement to address the challenge of climate change will require enhanced financial cooperation to support the development and transfer of green technologies, to reduce emissions from deforestation and to help the most vulnerable adapt.

Globally, we must deliver a substantial increase in public and private finance to support the design and delivery of ambitious climate adaptation and mitigation plans in developing countries. And we must underpin this finance with new institutional arrangements that are representative of developing, as well as developed countries; ensure strong financial management and coherence between instruments; and guarantee the provision of finance quickly and at scale in support of country-led climate plans, with a greater focus on supporting programmes as well as projects.

The World Bank and the other Multilateral Development Banks must prepare for an important role in these new arrangements: supporting the preparation of integrated national climate and development strategies, providing strong financial management for climate funding, and managing the delivery of key finance streams. In addition I propose the creation of a new high level body - fair, efficient and representative-to assess and provide guidance on needs and sources of funding, and to ensure that finance is allocated to the most pressing instruments and priorities.

Conclusion

Taken together these measures comprise a programme of reform that is a new way of governing the world economy - a way of governing that recognises our interdependence and our shared goals of growth, employment and a higher quality of life. I said at the London Summit that in this new world prosperity is indivisible, that the prosperity of each nation depends upon the prosperity of all, and that growth to be sustained has to be shared. This is not a time for complacency but a time for boldness.

Gordon Brown
Prime Minister