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G-20: International Cooperation Can Go Only So Far to End the Recession

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Those with high hopes for this weekend's meeting of finance ministers from the G-20 might want to rethink their enthusiasm for such an international confab. The many words produced in the next several days, some fine and some silly, are likely to have little ultimate impact on the economic situation.

Writing in Friday's *Wall Street Journal*, the G-20 meeting's host, U.K. Chancellor of the Exchequer Alistair Darling, paints a rosy picture of international cooperation: major countries working in partnership to restore global financial health. There is certainly nothing wrong with international cooperation or partnership, but each part of Darling's proposed scenario for coordinated action raises questions and has the potential for harm as well as good.

Can the Cure Be the Same as the Cause? Darling calls for G-20 coordinated action in three areas. First, he wants countries to boost demand through monetary loosening, fiscal stimulus, and restoration of bank lending. The idea is to flood the market with money, have government buy for the public all the things the public is currently unwilling to buy for itself, and pressure banks to make loans they are otherwise unwilling to make.

If the first and third parts of that—the monetary loosening and the pressure for more bank lending—sound similar to the policies most responsible for creating the crisis in the first place, it is because they are.

In addition, neither requires international cooperation. In fact, with international capital markets as well-connected as they are, changes anywhere in the system will automatically affect anyone in the system. Cooperating internationally at the level of governments could result in some burden-sharing, but it is hardly essential.

The middle part of Darling's recipe for stimulating demand—the fiscal stimulus—is a political move rather than an economic one. The resources the government spends are not free goods; they have to come from somewhere, either now or in the future. Fiscal stimulus is a windfall for politicians who want to have a much greater role in deciding who gets what in our economy. Politically favored groups will win as a result of fiscal spending, and politically unfavored groups will lose, but the overall effect on the economy will be close to zero—or, more likely, negative—because of the inherent inefficiencies of government.

IMF to the Rescue? Darling's second call is for an increase in International Monetary Fund (IMF) resources to help "prevent the spread of the crisis from corporations to countries." This is an entirely symbolic gesture. In what is approximately a $50 trillion world economy, the IMF, in its largest spending year ever (2002) provided less than $30 billion

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to member countries, or approximately 0.06 percent of the world economy.

There is no conceivable increase in IMF resources that will put the organization in a position to make a significant impact on a world financial crisis or recession such as we are currently experiencing. Nor should we desire such an increase, which would divert productive capital and resources from other uses. Yes, the IMF can help in isolated cases or in smaller economies, but its overall impact on the crisis will be negligible.

Cross-Purposes. Finally, Darling calls for the reform of global financial regulation. Here he advocates better management of risks "through early warning capabilities and colleges of supervisors." This is one place where agreement among the G-20 is likely and probably harmless, though one might be skeptical as to whether joint centralized scrutiny of risks will actually reduce risk. It might instead increase it by focusing regulators' thinking in herd-like manner toward only the popular problem of the day.

More troubling is Darling's assertion that "all types of risk to consumers, markets and economies need to be covered." It is, of course, through the assumption of risk by entrepreneurs that economies increase productivity and grow. One can always decrease risk—indeed, that was the hallmark of the centrally planned socialist economies of the Soviet Union and Eastern Europe—but at the cost of growth and prosperity. We can only hope that our central bankers will not go too far in that direction.

One way Darling would reduce risk is by putting a cap on banks' leverage ratios, requiring them to hold more reserves. But this would reduce banks' lending—exactly the opposite of what Darling was calling for as one of his first priorities. It may be that banks' leverage ratios, something already regulated in all countries, might need to be adjusted. But no one should pretend that the ratios of reserves to lending can be increased without reducing lending in the process.

Just Get Out of the Way. Darling can be excused for hyping the G-20 finance ministers meeting and its potential impact on the world crisis. He is, after all, the host of the event and he and his government have a substantial political stake in a positive outcome. The rest of us, however, should have no such illusions. Only a restoration of trust in markets and the prices of assets will end the malaise into which we have fallen. In that regard, an announcement by the governments of the G-20 of what they will not do to intervene in markets would probably go a lot further in restoring trust than any announcement of joint action or new regulations.

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