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# America must lead a rescue of emerging economies

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The global financial system as it is currently constituted is characterized by a pernicious asymmetry. The financial authorities of the developed countries are in charge and they will do whatever it takes to prevent the system from collapsing. They are, however, less concerned with the fate of countries at the periphery. As a result, the system provides less stability and protection for those countries than for the countries at the center. This asymmetry - which is enshrined in the veto rights the US enjoys in the International Monetary Fund, explains why the US has been able to run up an ever-increasing current account deficit over the past quarter of a century. The so-called Washington consensus imposed strict market discipline on other countries but the US was exempt from it.

The emerging market crisis of 1997 devastated the periphery such as Indonesia, Brazil, Korea and Russia but left America unscathed. Subsequently, many peripheral countries followed sound macroeconomic policies, once again attracting large capital inflows, and in recent years have enjoyed fast economic growth. Then came the financial crisis, which originated in the US. Until recently peripheral countries such as Brazil remained largely un-affected; indeed, they benefited from the commodity boom. But after the bankruptcy of Lehman Brothers, the financial system suffered a temporary cardiac arrest and the authorities in the US and Europe resorted to desperate measures to resuscitate it. In effect, they resolved that no other big financial institution would be allowed to default and also they guaranteed depositors against losses. This had un-intended adverse consequences for the peripheral countries and the authorities have been caught unawares. In recent days there has been a general flight for safety from the periphery back to the center. Currencies have dropped against the dollar and the yen, some precipitously. Interest rates and credit default premiums have soared and stock markets crashed. Margin calls have proliferated and spread to stock markets in the US and Europe, raising the specter of renewed panic.

The IMF is discussing a new credit facility for countries at the periphery, in contrast to the conditional credit lines that were never used because the conditions attached to them were too onerous. The new facility would carry no conditions and no stigma for countries following sound macroeconomic policies. In addition, the IMF stands ready to extend conditional credit to countries that are less well qualified. Iceland and Ukraine have already signed and Hungary is next.

The approach is right but it will be too little, too late. The maximum that could be drawn under this facility would be five times a country's quota. In the case of Brazil, for example, this would amount to \$15bn, a pittance when compared with Brazil's own foreign currency reserves of more than \$200bn. A much larger and more flexible package is needed to reassure markets. The central banks at the center should open large swap lines with the central banks of qualifying countries at the periphery and countries with large foreign currency reserves, notably China, Japan, Abu Dhabi and Saudi Arabia, ought to put up a supplemental fund that could be dispersed more flexibly. There is also an urgent need for short-term and longer-term credit to enable countries with sound fiscal

positions to engage in Keynesian counter-cyclical policies. Only by stimulating domestic demand can the specter of a world-wide depression be removed.

Unfortunately the authorities are always lagging behind events; that is why the financial crisis is spinning out of control. Already it has enveloped the Gulf countries, and Saudi Arabia and Abu Dhabi may be too concerned with their own region to contribute to a global fund. It is time to start thinking about creating special drawing rights or some other form of international reserves on a large scale, but that is subject to American veto.

President George W. Bush has convened a G20 summit for November 15 but there is not much point in holding such a meeting unless the US is serious about supporting a global rescue effort. The US must show the way in protecting the peripheral countries against a storm that has originated in the US, if it does not want to forfeit its claim to the leadership position. Even if Mr. Bush does not share this point of view, it is to be hoped the next president will - but by then the damage will be much greater.

The writer is chairman of Soros Fund Management and author of *The New Paradigm for Financial Markets*