The North-South Institute
L'Institut Nord-Sud

BACKGROUND PAPER FOR THE 2ND WORKSHOP

Policy Response to Unfettered Finance and the Reshaping of the Global Economy

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Introduction

Under the North-South Institute's project "Policy Responses to Unfettered Finance", our first workshop at Columbia University in NYC last February brought out a series of findings and policy recommendations that can be summarized in the urgent need for stronger and better financial regulation, more inclusive global economic governance, and a focus on sustaining basic needs when addressing the current global crisis[1].

These findings are very much in line with other similar initiatives taking place worldwide at different levels of policy dialogue[2]. Even from national governments and international organizations, policy statements have in general carried a roughly similar message but have so far come out with rather uneven measures to overcome the immediate effects of this crisis first, and address the structural reasons that brought it about later.

This background paper covers the two main policy responses to this crisis provided so far at the international level: the G-20 London Summit Leader's declaration, and recommendations of the UN Commission of Experts for the President of the General Assembly. We analyze and contrast here these responses with the critical view of what they do or do not provide for African low income countries (LICs) to overcome the effects of this crisis. Those effects on African LICs are first briefly summarized, followed by a review of what these two global initiatives have had to offer.

Upside-down or down right? Understanding the crisis from an African LIC's perspective

From the perspective of the African LICs, this crisis represents a sudden and very large drop in their international income generated mostly by earnings from commodity exports and remittances. For those countries that were receiving foreign direct investment, it also means a reduction in capital inflows or even its temporary cessation. Aid flows do not represent for most African LICs a very sizable source of income, but they remain very significant for most states' fiscal revenues. Considering previous instances of crises in the DAC countries, it is predictable that aid flows will fall as well, especially as the largest donors move into unprecedented fiscal deficits themselves[3]. In sum, the underlying irony for LICs in this particular circumstance is that the more involved they had become in the global economy, the more affected they are now by its crisis. In other words, the more integrated their economies had become with domestic and international markets, the more stricken they will be in the coming years.

Given this common negative effect of the crisis on LICs, it is then necessary to look the situations faced by different countries depending on the nature of their of relationships with the global economy and the levels of market-economy integration. The first of the generalized conclusions that can be drawn so far is that, in the short term, populations in several if not most LICs will need supplemental sources of income in order to cover their basic needs and that gives an urgent character to the response to this crisis. The second is that such response must be targeted, according to the needs of each individual country, not using a one-fits-all approach that would most likely not reach the objectives in the most affected countries, and simultaneously squander resources in other nations with lesser levels of economic emergency. The obvious corollary is

[1] See more details in NSI Briefing Note: Policy Responses to Unfettered Finance and the Reshaping of the Global Economy, March 2009, at http://www.nsi-ins.ca/english/research/progress/61.asp .
2 See as examples, statements from Institute for Development Studies http://www.ids.ac.uk/go/infocus7 , the Center for Global Development http://www.cgdev.org/content/calendar/detail/1421273, the Commonwealth Foundation – Center of Concern http://www.commonwealthfoundation.com/news/news/detail.cfm .
[3] See the example of the Scandinavian Financial Crisis of the early 1990s on those countries ODA flows at the 2009 Global Monitoring Report of the World Bank, p. 119.

that a legitimate allocation process must be put in place at regional development banks, the BWIs and other international actors tasked with this from the UN or the G-20.

Beyond the emergency brought by the short-term effects of the crisis, the latter also occasion a cause for reflection on whether the market-opening policies followed in most LICs until recently under the prodding of the BWIs and also, under their very own domestic political and economic leaderships, need further deepening, just some fine-tuning, wholesale reform, or a full reversal. After all, the crisis is clearly demonstrating so far that the more a country did to open up its economy, and exercise its static comparative advantages via the export of raw materials (commodities) and cheap labour (labour-intensive exports and migration), the more vulnerable it has become to a crisis born and developed beyond its boundaries, and beyond its sphere of influence in global economic governance.

Effect of the Crisis on African LICs[4]

Macroeconomic impacts

Economic growth in African LICs is expected to slow-down to a rate of 2.9% in 2009, from 5.7% in 2008 and 6 % in 2007. Most of the slow-down will be in oil and mineral exporting countries, as those commodities are the hardest hit by lower international prices, falling from their 2008 peaks. The slow-down will impact directly on the current account and the fiscal balances of these countries, as their finances are strongly dependent on external trade in a very pro-cyclical manner (tax income on exports and imports, feeding current expenditures). Overall, African LICs will have a deterioration in their states' budgets of over 7% of their GDP, as they move from a surplus position in 2008 of 2.3% of GDP to a forecasted 2009 deficit of 5.5%. Again, oil and mineral exporters such as Angola, Nigeria and Democratic Republic of Congo will register the most important deficits of around 7% of GDP 2008, while agricultural exporters such as Ethiopia and Uganda will have much milder deteriorations, from 1.6% deficit in 2008 to 2.8% deficit in 2009. Just as in the case of fiscal balances, current account balances will improve or worsen according to the trade mix of each LICs, with oil-importers facing the strongest improvement, and those most concentrated in exports of oil and minerals facing the worst effects of the fall in commodity prices due to the crisis. Net-food importers will have a slight improvement in their accounts as well, depending on the composition of their imported food basket, as food prices have had a rather uneven path toward lower prices since their peak in 2008.

Transmission channels

Trade: overall, growth in African exports to the world will be negative, at around 7%, slightly less than the expected contraction of 10% in total global trade for 2009. Imports will also decline by 5%. The effect depends mostly on the evolution of international prices, in turn determined by how the economies of the European Union, NAFTA and the BRICS perform in the short to medium term. While aggregate demand in most importers of the commodities produced by African LICs is definitely falling, the quantities demanded are not falling as much, as their price elasticity and substitution is rather limited.

Evolution in the prices of the main commodities exported by African LICs

% Change	2000-2005	2006	2007	2008	2009*	2010**
Energy	13.5	17.3	10.8	45.1	-25	0.9
Oil	13.6	20.4	10.6	42.3	-26.4	1.8
Natural Gas	10.4	33.9	1	57.2	-10.8	-4.2

[4] This section draws extensively on the African Development Bank's Working Paper No. 96, Impact of the Global Financial and Economic Crisis in Africa, 2009.

Coal	12.7	3.1	33.9	97.8	-23.1	-10
Non energy	8.3	29.1	17	22.4	-23.2	-4.3
Agriculture	6	12.7	20	28.4	-20.9	-1.3
Foods	6	10	25.6	35.2	-23.4	-0.3
Grains	4.8	18.4	26.1	50.9	-27.7	2.6
Raw materials	5	22.7	9	13	14.9	2.7
Metals and minerals	12.3	56.9	12	5	25.5	5.5
Cooper	15.2	82.7	5.9	0.6	-32.2	-4.2

* Up to April 2009
** Forecast made in April 2009
Source: World Bank, Global Economic Prospects 2009: Commodity markets

Finance: Africa's low level of global financial integration meant that African LIC economies are relatively isolated from the direct impact of the financial crisis, as their financial institutions held virtually no subprime mortgage-backed securities. On the other hand, these African countries are however suffering from indirect effects – a generalized increase in risk aversion and reversal of capital flows.

While the external financing needs of the whole of Africa only represented 4% of the total borrowing internationally by developing economies in 2007, that marginal participation still represents a large part of the financial needs of African countries. Examples are at hand in the cases of Ghana, Kenya, Uganda and Tanzania, nations that had to postpone indefinitely the issuing of international bonds due to the exorbitant rates they would have to pay if issued in early 2009. Besides that, private foreign borrowing by African LICs' banks is still heavily regulated in the context of exchange control. Thus, these banks have encountered little risk associated with off-balance sheet operations. This also explains the limited impact on the banking sector in Africa so far.

However, this is not to suggest that the financial sector in Africa is absolutely immune to the effects of the crisis due to its limited direct exposure to troubled mortgage-related assets. Unlike more advanced markets while there has been no systemic banking crisis in the region thus far, domestic financial sectors are however vulnerable to substantial weakening of client incomes and debt servicing capabilities, especially since credit growth has been rapid in recent years. Banks also tend to have highly concentrated lending portfolios, as major commodity based industries decline problems in these sectors could quickly spread to banking systems. Furthermore, of late in some countries (e.g. Kenya, Nigeria, and Uganda) banking systems have become more exposed to market volatility as high equity returns led to borrowing to invest in stock markets. Foreign banks also play a large role in African financial systems, risks of contagion increase if distressed parent banks withdraw capital from subsidiaries, call in loans and or curtail lending.[5] These are some of the financial linkages that may yet prove to be Achilles heels.

Remittances: Recent data on migrant remittances has shown partial evidence of stagnation or slight decline worldwide. However, in the absence of more extensive information, it is still difficult to draw conclusions. The World Bank recently concluded a forecast exercise and estimated remittances would fall between 5 and 9% worldwide in 2009, a tendency that could worsen in 2010 if the global crisis continues[6]. In such a scenario, immigration controls would increase further, regulations tighten and stimulus packages include even more provisions that limit the recruitment of foreign workers or foreign residents. The migrants from LICs who would be most affected are those working in the Gulf Cooperation Council countries and in the MENA region

[5] IMF Africa Department, (2009) *Impact of the Global Financial Crisis on Sub-Saharan Africa*
[6] The conclusion that remittances will fall further as the crisis worsens in migrants-receiving countries is however challenged by some researchers and migration specialists.

(Middle East and North Africa), where their remittances are expected to fall by up to US $2bn[7]. The social impact of this would be substantial as most remittances play a significant role in maintaining minimum living standards in otherwise vulnerable populations.

Workers' remittances, compensation of employees, and migrant transfers, credit (US$ million) (Sample of African LICs)

	1991	1996	2001	2006	2007	2008	*Remittances as a share of GDP, 2007 (%)*
Benin	118	86	84	224	224	271	**4.1%**
Burkina Faso	113	80	50	50	50	50	**0.7%**
Comoros	10	12	12	12	12	12	**2.6%**
Côte d'Ivoire	41	147	116	167	179	215	**0.9%**
Ethiopia	10	16	18	172	359	359	**2.0%**
Gambia	14	20	7	64	47	64	**6.9%**
Ghana	6	28	46	105	117	128	**0.8%**
Guinea	..	1	9	42	151	151	**3.0%**
Guinea-Bissau	-	2	10	28	29	30	**8.3%**
Kenya	124	288	550	1,128	1,588	1,673	**5.4%**
Mali	93	111	88	212	212	212	**3.3%**
Mozambique	56	61	42	80	99	99	**1.3%**
Niger	13	4	22	66	78	78	**1.9%**
Nigeria	66	947	1,167	5,435	9,221	9,979	**6.7%**
Rwanda	4	5	8	21	51	51	**1.9%**
Senegal	163	150	305	925	925	1,000	**8.5%**
Sierra Leone	..	25	7	50	148	150	**9.4%**
Togo	29	29	69	229	229	229	**8.4%**
Uganda	..	..	342	665	849	875	**7.2%**
All developing countries	34,109	62,343	95,217	228,694	280,679	305,281	**2.1%**
Low-income	4,305	6,204	10,884	30,940	39,939	45,129	**5.9%**
Middle-income	29,804	56,138	84,333	197,754	240,740	260,152	**1.9%**

Source: World Bank staff estimates based on the International Monetary Fund's Balance of Payments Statistics Yearbook 2008.

The G-20 London Summit Declaration: what is in it for LICs?

The G-20 leaders met in London in early April and came up with a number of initiatives on trade, investment, finance and aid to address issues that are relevant to all countries, but affecting perhaps most strongly those with lower incomes. That result was indeed surprising as the G-20 had been previously expected to coordinate policy among its members in regard to their own financial regulation and fiscal stimulus packages, given their status as core industrial economies and largest developing economies. Given their evident disagreement on these issues, attention was turned instead to give explicit responses on what ought to come from the BWIs. The G-20 added a commitment to continue with the Doha Development Round at the WTO and promised to maintain current aid flows, and its concurrent framework addressing the Millennium Development Goals. In contrast, no explicit reference was made to immigration or remittance issues, another transmission channel of the global crisis, greatly affecting LICs.

[7] See *Migration and Development Brief 9*, published by the World Bank. Available at: http://siteresources.worldbank.org/INTPROSPECTS/Resources/MD_Brief9_Mar2009.pdf

On trade, the G-20 reaffirmed their rejection of across-the-board protectionism and extended for another 12 months their previous commitment not to engage in such practices, an important issue for LICs as they continue to depend on market access to G20 countries for their exports and most have little capacity to fight these measures bilateral or multilaterally. That anti-protectionist pledge is however to be taken with a grain of salt: the WTO reported last April that 17 of the G20 countries represented in London had initiated protectionist trade measures of different kinds in the last six months[8]. The aggregate impact of those measures is however so far relatively small.

The G-20 also restated its commitment to complete the WTO Doha Development Round at the earliest possible time to signal their unwavering support for freer international trade, and a more level playing field[9]. The current agreement, which was not signed in July 2008, implied some reductions in agricultural protection and export subsidies in the OECD countries in exchange for quite large reductions in tariffs on industrial goods among the developing countries. Most LICs could conceivably profit from that enlarged market access if they could mobilize internally or receive from abroad sufficient capital and technology to produce agricultural goods demanded abroad. On the other side, the large impact of reductions in bound tariffs for manufactured goods would most likely mean a net reduction in their effective gains from trade[10]. Furthermore, in the event of a deal, the erosion of developing countries' existing trade preferences will accelerate, albeit starting from a very low base.

A subject that grabbed much of the attention at the London meeting is trade financing, which ranks among the most short-term credit facilities. Working on the assumption that the financial market's freeze in developed countries has triggered a dramatic shortfall in trade financing worldwide, the G-20 committed US$ 250 billion to that goal. It is however not clear yet whether most of that amount will be administered by MDBs, G-20 export-import banks, or the World Bank. That is key to determining how that funding is allocated[11].

On financial governance, the creation of the Financial Stability Board brings no change for the LICs since none of them were invited to become part, thus limiting their capacity to make their particular needs and demands be heard in the restructuring of the global financial architecture and future agreements on international banking regulations. The G-20 also expressed its commitment to enlarge the participation of developing countries at the IMF in the mid-term future (January 2011), privileging instead for the short term measures to enlarge its capacity to lend via the issue of US$ 250 billion in SDRs, that can be expanded to US$ 500 billion more. The increased voice for developing countries is not explicitly addressed in the communiqué but subsequent public statements from the G-20 countries give the impression that these changes are to make room for the larger developing countries, plus a few management changes to give some more direct input to LICs. New flexibility in lending by the IMF is applauded at the G-20 but surprisingly, no more of it is called for. That leads one to wonder whether pro-cyclical contractionary programs will still be the menu for LICs calling on the IMF for funding. Finally, a similar but much weaker reform mandate will take place in the World Bank on the lines of the October 2008 agreement.

In terms of concessional financing and aid, the G-20 statement pledges US$ 6 billion coming from IMF gold sales over in the next 3 years. Otherwise unspecified aid commitments are said to amount to a total of US $ 50 billion (in an again unspecified time frame) to support social safety nets in low income countries, contributions to the WB's Vulnerability Framework, Infrastructure Crisis Facility, and Rapid Social Response Fund. Those are implicitly related to the own G-20

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[8] WTO report on protectionism, text at http://www.iatp.org/tradeobservatory/library.cfm?refID=105582 .

[9] Sandra Polaski (2008) Impact of the Doha Round on Developing Countries, Carnegie Endowment for International Peace, New York.

[10] Martin, Will; Mattoo, Aaditya; (2008) The Doha development agenda : what's on the table? Policy Research Working Paper ; no. WPS 4672 .

[11] For example, trade credits from industrial countries' export credit agencies can be expected primarily to benefit domestic firms in those countries.

reaffirmation of their support for meeting the MDGs globally, respecting their pre-existing ODA pledges, and other international agreements seeking to firm up aid flows.

So far, the headline figure of $50bn can be broken down as follows[12]:

* Doubling the IMF's lending capacity for low income countries through the Poverty Reduction and Growth Facility (PRGF) and Exogenous Shocks Facility (ESF). This is reported as a provision that will facilitate another $4bn, with a further $6bn in lending facilitated through interest rate subsides facilitated in part by gold sales. The PRGF and ESF operate through an IMF-administered Trust Fund financed by member contributions and the IMF itself. PRGF loans are provided at 0.5 per cent interest repayable within 10 years with a five year grace period. The PRGF has a grant element of around 30 per cent, which is far less concessional than the World Bank's International Development Association (IDA) facility.[13] The latter provides interest-free credits repayable over a 35-40 year period (with a ten year grace period) – more than double the concessionality available through PRGF.
* More Special Drawing Rights (SDRs). Another $19bn is expected to arrive through the low-income country share of the new Special Drawing Rights (SDRs) Issue (with another $2bn through an amendment to SDR rules).
* Increased Multilateral Development Bank (MDB) lending. Around $6bn is expected to come through multilateral development bank financing for the private sector in low income countries, most of it through the extension of IBRD (non-concessional) loans to low income countries. This provision is linked to a proposal to increase IBRD lending by $100bn over the next three years – a commitment made several months ago, with countries such as the Ukraine, India and Indonesia identified as early potential beneficiaries.
* Increased support for the International Finance Corporation's trade liquidity pool. This is expected to generate $12bn in finance for low-income countries. It is not clear how much of the headline amount is a new commitment – or whether the resources will materialise. The agreement to launch a trade liquidity fund under the IFC, the World Bank's private sector division, to provide short-term trade credits predates the G20 summit (it was announced in February, 2009). The agreement at the summit was to provide $3-4bn in bilateral contributions to the IFC pool. Uptake will depend on the degree to which firms and banks underwrite risks in the poorest developing countries. The resources are non-concessional.

The sum of these parts would indicate that as far as the G-20 are concerned, LICs do need help but that is to be dispensed by the same institutions that have contributed to and occasionally undermined their particular development paths in the last three decades, by the same programmes, and one can almost say by the same people in those organizations (IMF, WB, MDBs, aid agencies, etc). The G-20 support implicitly means as well giving more power to the IMF and less to the World Bank, in spite of the known (and self-acknowledged) inability of the Fund to deal with poverty issues when providing emergency financial assistance[14]. More troubling, and not only for LICs but for all developing countries, is the fact that the IMF governance issues remain unresolved and openly moved to the back-burner. That back-burner will eventually become central when the G-20 decide to revisit their own pledge of "identify and work together on further measures to build sustainable economies".[15]

UN Commission of Experts for the President of the General Assembly. What is in it for LICs?

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[12] Kevin Watkins (2008) The G-20 Deal – good for the world, not so good for Africa. Downloaded on May 22nd, 2009, from http://www.globaleconomicgovernance.org/blog/2009/04/ .

[13] We should also note that the World Bank as part of its response has frontloaded and fast-tracked $2bn of the $42bn IDA facility, starting in December 2008

[14] See full report at the site of the Independent Evaluation Office of the IMF at http://www.ieo-imf.org/eval/complete/eval_07062004.html .

[15] See paragraph 27 of the G-20 London Summit Leaders' Statement.

This Commission, headed by US economist Joseph Stiglitz, produced a summary report in March and will soon make public an expanded version of its recommendation to the President of the UN General Assembly. While these recommendations are not binding for either the Presidency of the UN General Assembly or for any of its 192 member countries, they do carry significant political influence in UN agencies and deliberative bodies.

The recommendations have coalesced in a proposal, made by this 18-member commission, which has two related priorities: one focusing on the governance mechanism to address the crisis, and the other, on the content of the measures to act on it, in turn summarized in 10 main points. The central proposal on governance is to replace the de-facto leadership position established by the G-20 in its Washington and London meetings so far by a UN Global Economic Council, constituted by 20 to 25 countries elected from the UN General Assembly, and independent from the veto powers of the UN Security Council.

To give content to this new Global Economic Council, the Stiglitz UN Commission proposes a series of measures, starting with the creation of a new global reserve system that would provide support to developing countries, especially to those with lower incomes, on a regular basis and would not be subject to veto by industrialized countries that today dominate the BWIs, and particularly the IMF. Besides reducing the current monetary straitjacket of most LICs, this plan also calls for the OECD countries to set aside one per cent of their fiscal stimulus packages to spend in further aid and assistance to developing countries, in addition to existing foreign aid budgets. The combination of enlarged money supply and increased aid would reduce LICs' constraints to counter this crisis. In that same line of reasoning, the Stiglitz Commission criticizes the IMF for continuing to give "misguided policy recommendations" and loan - conditionalities that in effect prevent developing countries from adopting any of counter-cyclical stimulus policies that are currently being pursued by the developed countries.

It also calls on industrialized countries to follow their own promises to avoid protectionism and to make sure that their stimulus packages do not further distort international trade and investment flows, increasing global imbalances against the poorest countries. That concern must be extended to the impending WTO negotiations, where this proposal suggests that the principle of special and differential treatment is preserved for LICs.

Conclusions and Discussion Questions

This short backgrounder has presented a decidedly bleak picture. There is however an unavoidable need for discussion of what future is there for the development ideas and practices that have guided LICs in the last decades. That path first meant going through painful structural adjustments, and more recently, fleeting improvements in social and economic indicators, the much-desired effects of economic development through increased global integration. Two interrelated premises stand for this discussion:

- Is such policy synthesis, often named "Washington Consensus", in need for review given what is happening in LICs; and is that the most useful discussion to have at this point in time, given the sense of economic urgency in these countries?

This paper presented some of the key linkages or transmission channels by which this crisis is and may continue to affect LICs. External financing has accounted for an important share of these countries resource needs.

- Given the prospects for external financing, be that via exports earnings, remittances, ODA or private flows, have turned sharply negative does this reinforce the case for enhanced domestic resource mobilization, through greater savings mobilization effort, strengthening private financial markets, improved tax mobilization and more efficient public expenditure?

Clearly one of the enduring themes to be reinforced from the experience of the crisis is the rapid emergence of key large economies like China, India, Brazil, South Africa and others which to quote Mohamed El –Arian ‘represent economic and financial forces whose impact are of great consequence but cannot as yet be adequately sustained by the world’s current policy and market infrastructure’. Clearly these emerging economies which are set to be the main global growth drivers are influencing not only recovery prospects but also global governance (exemplified by the G20).

- Given the urgent social and economic needs demonstrated by this crisis in the African LICs, and the current weaknesses of their traditional Northern partners, what strategy can the former build to have South-South linkages compensate for that?

In terms of the emerging governance framework:

- How can forums such as the G20 become good ‘proxies’ for lower income country needs and interest? Are radically different negotiating and deliberating platforms needed?
- The alternative being discussed at the UN, the Global Economic Forum provides one such different platform. What are its prospects and impediments to achieve anything useful for African LICs, and what strategies might work there best to compensate for the disproportionate influence of larger developing and advanced economies?

The G-20 and UN Experts Commission have already provided statements rich in terms of insights for future policy responses LICs can expect (or discount). The analysis of these processes (G20 meeting next in the US and the High Level UN Conference in late June) and the politics behind as well as propelled by them, constitute a realistic platform for insertion of the recommendations our workshop participants will be asked to provide.