FINANCING DEVELOPMENT IN TIMES OF GLOBAL CRISIS

By Roy Culpeper

Introductory Remarks on *Canadian Development Report 2009*
Munk Centre, University of Toronto, April 1, 2009

Let me begin by putting *Canadian Development Report 2009* in context. This year our report is particularly topical since it coincides with the still-unfolding global economic crisis. The report was originally conceived as a contribution to the international Financing for Development conference convened at Doha at the end of November last year.

However, as we were putting the report together, the financial meltdown that began in the United States rapidly became a crisis engulfing poor countries as well as rich around the world. So the issues we raise in *CDR2009* became even more pressing. Poor countries, for no fault of their own are bearing the consequences of wrong-headed policies and choices made in the rich countries. Their demands need much more urgent attention. This should not be seen as a matter of altruism but rather one of recompense. However, it would also help to catalyze the recovery in the rich countries and hence serve their self-interest. I shall say more about this shortly.

But let me say parenthetically that this report is not The North-South Institute's only contribution toward understanding the present crisis and identifying ways out, particularly for the developing countries. We are also engaged in a project entitled "Policy Responses to Unfettered Finance in the Global Economy." The central research question in that project is, "What 'development friendly' reforms to global financial governance are required in order to ensure that the needs and priorities of developing countries are reflected in the response to the crisis?" In February we convened, at Columbia University in New York, an extraordinary workshop to address this question. It was extraordinary because we brought together members of civil society organizations, individuals from Wall Street, policymakers from intergovernmental organizations, and researchers. Participants from these disparate communities had, unsurprisingly, very different perspectives on the issues and prospects for their resolution, but still managed to find common ground. A policy brief from that workshop is about to be released. We are planning two more workshops in the remainder of the year, one in Geneva and the other in Delhi.

Let me now turn to *CDR2009*. As usual, the report contains a statistical annex rich with data and information that should be useful for students and policymakers concerned with international development. I shall focus principally on chapters written by contributors not with us today. The opening chapter was contributed by Amar Bhattacharya, Director of the G24 in Washington. (The G24 represents the interests of the developing countries at the World Bank and IMF.) Bhattacharya shows that from the mid-1990s until the onset of the current crisis the developing countries were the locomotives of the global economy, their growth rates outpacing those in the rich countries. The developing

countries' contribution to global growth increased from 40 percent in 2000 to more than 70 percent in the last two years. Nor has the growth been confined to China, India and other Asian "tigers". A striking feature has been a significant acceleration in sub-Saharan Africa's growth rate to around 6 percent in 2005 after two "lost decades" in that region.

Bhattacharya argues that the impressive economic performance achieved since 1990 by developing countries helped not only to fuel global growth, but also to reduce poverty levels. These gains may now be severely eroded or lost. As a result of the crisis, manufacturing exports from China and other Asian countries are rapidly falling, wiping out millions of jobs, while oil and other commodity prices, which have propelled much of sub-Saharan Africa, are retreating rapidly from their peaks last year.

Bhattacharya shows that in the run-up to the crisis, private capital flows to developing countries had increased fivefold from 2003 until 2007, when they reached US$1 trillion. For a while it seemed that the emerging market countries, which had accumulated over $2 trillion in foreign exchange reserves, were effectively "decoupled" from the deepening crisis in the rich countries. But by August 2008 that notion seemed baseless, as foreign investors and banks withdrew from those markets, sending their stock prices down by 50 percent or more over the last six months.

Perhaps the most ominous fact in Bhattacharya's chapter relates to foreign aid, which began to fall in 2005, at the height of the boom, even *before* the crisis erupted. This occurred despite the Group of Eight leaders' commitment during the Gleneagles Summit that year to increase aid by $50 billion a year by 2010, of which at least $25 billion would be for Africa.

As you know, the severity of the crisis is being compared with that of the Great Depression almost eighty years ago. Thus the attention of the richest and most powerful countries will no doubt be focused primarily on resolving their pressing domestic problems—mounting unemployment, mortgage foreclosures, factory shut-downs and so on.

Yet there are a number of things that can be done quickly to ensure that needs of the poorest countries and people are also met. As my colleagues John Foster and Rodney Schmidt argue in their chapter, there are a number of possibilities for innovative financing. A key finding of Rodney's research is that considerable sums can be raised efficiently by the industrial countries through a very small tax on international currency transactions. Rodney will speak about this at greater length. If implemented, the currency transactions tax could make a considerable contribution toward the additional $50 billion per year in foreign aid that the G8 countries committed to mobilize by 2010—a target which seems otherwise highly unlikely to be met as fiscal deficits rise.

In a chapter written jointly with my colleague Aniket Bhushan, we argue that developing countries themselves should also mobilize more resources domestically, for example, through more effective taxation, and better financial intermediation. Rich countries can help by in a number of ways. You shall be hearing more on this subject from Aniket

shortly. However, I would also add that this chapter is based on an ongoing project focused on domestic resource mobilization in sub-Saharan Africa, which we believe is more vital than ever because of the global crisis.

The current crisis also offers opportunities to reassess the conventional wisdom on development. There is no doubt that economic growth is a vital prerequisite for poverty reduction. Yet, Fabrina Furtado, a Brazilian who is Executive Secretary of Jubilee South (a network of social movements in fifty countries) challenges many of the fundamental tenets of the neoliberal growth model that has prevailed over the past few decades. In her chapter of the report, Furtado argues that much too little of the growth of the last three decades has benefited the poorest people, even in countries experiencing rapid growth rates. Indeed, policies of globalization have served to increase inequalities throughout the world, sometimes dramatically. She highlights the many recent initiatives sweeping across the Latin American region aimed at bringing about development that genuinely benefits the poor majority through closer regional co-operation. However, Furtado argues that many regional co-operation initiatives do not necessarily offer significantly different policy alternatives to the old neoliberal model. She illustrates with the examples of the Bank of the South, the Initiative for the Integration of Regional Infrastructure in South America, and the Brazilian National Bank for Economic and Social Development. Entitled “New Forms of Co-operation: for what and for whom?” Furtado’s chapter asks some searching questions on which we should reflect during the current economic crisis.

Thus, a key message we would like you to take from the report is that developing countries and policymakers urgently need a new policy roadmap, as well as new institutions, to ensure that recovery from the crisis, and future growth, will benefit the world’s poorest people, sooner, not later.

[As everyone here should know, G20 leaders meet in London tomorrow. Last week, in an interview with The Times of London, influential investor George Soros was not optimistic—he said the odds were that the meeting would fail because of deep differences of opinion. If so the price could be years of economic devastation worse than the Great Depression. However, in an appeal that resonates with *Canadian Development Report 2009,* Soros exhorted the G20 leaders “to come up with practical measures that are going to provide protection to the developing world, periphery countries, against a storm that originated from the centre, against a calamity that is not of their own making.”

However, no matter what happens tomorrow, the G20 does not, and should not, have the last word on saving the world economy. I will close by mentioning there is also a high-level international conference being convened by the UN on the economic crisis in early June. The President of the UN General Assembly has commissioned a panel of experts, led by Professor Joe Stiglitz at Columbia University, to recommend reforms of the international monetary and financial system. The panel brought down its report which was discussed late last week. It makes a number of recommendations that will require extensive international negotiations and take time—many months, if not a few years—to implement. The Institute will be closely monitoring and analyzing these events and reports through its ongoing project on the economic crisis. So stay tuned!]

As everyone here knows, last week the leaders of the G20 met in London to discuss their response to the global economic crisis. One can summarize the agreement that emerged as follows: the Americans did not succeed in persuading the Europeans to inject more fiscal stimulus than they already have into their economies; and the Europeans did not succeed in persuading the Americans to create a new Global Regulatory Authority to help ensure that all countries are implementing the necessary regulatory reforms to avoid future financial crises. However, the G20 did agree to inject US 1.1 trillion ($1,100 billion) into the global financial and trading system through the IMF ($750 billion), the multilateral development banks ($100 billion), and through the export credit agencies and others to finance trade ($250 billion). This was significantly more than most observers expected. They also discussed reforming the governance of the IMF and World Bank to give greater voice and representation to the developing countries.

Perhaps most surprising was a decision (as part of the $750 billion increase channeled through the IMF) to allocate an additional $250 billion in Special Drawing Rights to provide greater liquidity, particularly for the world's poorer countries. This represents a substantial increase in SDR allocations. It is fair to say that this would not have happened if it were not for the Chinese, who have recently advocated creating a new world currency. The SDR was created forty years ago as a new synthetic international currency—and it makes sense to utilize it since it already exists.

It is uncertain how and even whether these decisions will be implemented because they will require further negotiations in the governing bodies of the institutions concerned. Perhaps most worrying is the kinds of policies the IMF will insist on with its augmented resources. It would be a mistake for the IMF to revert to the failed policies of the past, for example after the Asian financial crisis. It would be much better to agree on a new policy approach without the kinds of conditionality characteristic of the IMF in the past two decades, before it is entrusted with the new resources.

Debate will no doubt continue over the coming year as and when the G20's decisions are implemented. Continued vigilance and pressure will be needed to ensure that the international financial institutions do the right thing—or at least, stop doing the wrong things.