UNITED NATIONS

Department of Economic and Social Affairs

Background Note on

THE GLOBAL FINANCIAL AND ECONOMIC CRISIS, ITS IMPACT ON DEVELOPMENT, AND HOW THE WORLD SHOULD RESPOND

March 2009

THE SETTING

1. **The world is mired in its worst recession since the 1930s.** The rapidly unfolding global financial and economic crisis is going to severely disrupt economic growth worldwide and endanger progress towards achievement of the MDGs and the other internationally agreed development goals. The ILO estimates that worldwide as many as 50 million more people will become unemployed and as many as 200 million will join the ranks of the working poor between 2007 and 2009, if the right policies to redress the situation are not taken immediately. If prospects continue to worsen, many more people could be affected. The UN's global forecast sees negative per capita income growth for much of the developing world in 2009, putting the livelihoods of billions at stake.

2. **The present crisis emerges on the back of an unsustainable global growth pattern** characterized by strong consumer demand in the United States, funded by easy credit and booming house prices. Far-reaching financial deregulation facilitated a massive and unfettered expansion of new financial instruments, such as securitized sub-prime mortgage lending, sold on financial markets worldwide. This pattern of growth enabled strong export growth and, eventually high commodity prices benefiting many developing countries, but also led to mounting global financial imbalances and overleveraged financial institutions, businesses and households. In the context of a highly integrated global economy without adequate regulation and global governance structures, the breakdown in one part of the system thus easily leads to failure elsewhere, as we are witnessing today.

3. **Developing countries are particularly adversely affected by the systemic flaws in the global financial system.** At lower levels of development, they are less resilient and thus more vulnerable to fluctuations in world markets:

- With fewer resources they are also more typically forced to pursue pro-cyclical monetary and fiscal policies, imposing greater variability in their economic performance and affecting long-term growth.
- They are also unable to provide massive guarantees and subsidized bail-out packages to financial institutions as these are being provided by developed countries to salvage their financial systems. This asymmetry may also be the source of unintended, yet unfair trade practices.[1] This highlights the need to ensure coherence in the global system of trade, aid, debt and finance, to avoid unfair trading practices as a result of imbalances in the capacity to respond to the crisis.
- Such asymmetries are exacerbating global inequality by inducing capital outflows from developing countries to provide liquidity to the financial systems in Europe and the United States.
- Following the breakdown of the Bretton Woods system of fixed exchange rates in 1971, exchange rates have been marked by high volatility. Especially for small open developing economies, it is not easy to maintain macroeconomic stability in the face of such volatility as it imposes high costs to firms engaged in international trade lacking adequately functioning insurance markets.

4. **Developing countries have limited capacity to respond with counter-cyclical policies**. But the system also does not work well for the developed countries. This is visible from the present recession and collapse of major financial institutions, but also from the persistent and large global financial imbalances. The huge reserves held by quite a number of developing countries as insurance against world-market volatility, has fed mounting trade deficits elsewhere, especially in the United States, which eventually will force a steep fall in the value of the dollar. If the global imbalances unravel in a disorderly fashion this may well turn into a hard landing of the world's reserve currency with major disruptive consequences.

5. **The current crisis comes on top of the 2008 food and energy crises:** At the beginning of the 21st century, half of the world population was living in poverty, surviving on less than two dollars a day. The World Bank estimates that 45 million more people will fall into extreme poverty in 2009 as their incomes will fall below $1.25 per day; while an additional 53 million people would see their incomes drop below the $2-a-day poverty line. The global financial crisis comes on top of the food crisis in 2008, which pushed already more than 125 million people into poverty. The current global economic crisis will hit even harder with rapidly unemployment rising rapidly, real incomes falling and fiscal resources shrinking and forcing many countries to cut back on social spending.

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[1] For example, bailout money provided to domestic automobile companies in a developed country in fact is an implicit subsidy putting such industries in competitive advantage to comparable industries from developing countries.

6. **The current crisis, therefore, must be addressed in ways that:**
   - reflect the realities of the existing global imbalances;
   - will reduce the asymmetries between developed and developing countries in undertaking necessary counter-cyclical policies and providing additional social protection;
   - tackle the systemic flaws in the global financial system;
   - prioritize job creation and poverty reduction; and
   - lay the foundation for truly sustainable global development.

   Unless this is done, poverty will increase sharply worldwide, with major set backs in the world's efforts to achieve the MDGs. The high oil and food prices which preceded the present crisis already constituted a major setback for many developing countries and also made them even more poorly prepared to face the consequences of the present crisis. Rising unemployment and poverty will confront countries with increased social needs, but decreases in government revenues will provide them with fewer resources to meet those needs. If countries are forced to cut back on social expenditures, this will have long-lasting effects on education and health of their populations, with lifelong effects on children and youth.

7. **Failing to meet those social demands could well trigger devastating social tensions,** especially in a context in which trillions are spent on financial sector bailouts. Failing to do so may also impair the sense of global solidarity, making agreement on other key global issues, such as responding to the challenges of climate change, more difficult.

8. **World leaders have recognized the need for concerted global action to combat the crisis**:
   - Major industrialized countries have already coordinated a set of monetary measures and massive financial rescue packages totaling about $11 trillion, though without producing desired results.
   - Major economies, including some developing countries have put together fiscal stimulus packages totaling (as per mid-February 2009) about $2 trillion (about 3% of world gross product, WGP), but to be spent over a number of years. Yet, despite rhetoric by world leaders that these packages should be implemented in coordinated fashion, little such coordination has taken place in practice. The size of the combined package seems to fall short of what is needed, which more likely should be in the order of about *3% of WGP per year* (see below).
   - At a special session of the UN General Assembly held on 30 October 2008, Member States called for concerted, major reforms of the international financial architecture and the President of the GA appointed a Commission of Experts to advise on reforms of the international monetary and financial system.
   - A meeting of the Group of 20 major developed and developing countries met in Washington D.C. on 15 November 2008 to set in motion a plan of

action of concerted responses to the crisis and reforms of the financial system.

- At the *Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus*, held in Doha, Qatar, from 29 November to 2 December 2008, Governments agreed to address systemic problems and to fundamentally reform the global financial system. They also requested the General Assembly to organize a meeting at the highest level on the world economic and financial crisis and its impact on development; a meeting which is now scheduled for 2-4 June 2009.

A TEST OF MULTILATERALISM

9. **The global economic crisis presents a test of the strength of multilateralism**. Lack of adequate international coordination in practice not only endangers economic recovery and achievement of the MDGs, but may have wider security repercussions. History shows that economic unilateralism has often also led to political unilateralism and increased tensions among countries.

10. **Protectionist responses must be resisted.** The crisis has already given rise to intended and unintended protectionist measures and unfair trading practices, as indicated. Rejecting protectionism is not an easy course to follow, but will be essential. Trade amongst countries provides a powerful stimulus to the global economy. Leaders of the G20 pledged in their meeting of November 2008 to refrain from raising new barriers to investment and trade, imposing new export restrictions, or implementing WTO inconsistent measures to stimulate exports. Nonetheless, there have been instances of introduction of new protectionist measures. These must be reversed and a mechanism should be put in place to monitor and challenge new protectionist measures.

11. **Leadership of major countries in pursuing internationally concerted action is important, but not sufficient**. Ad-hoc gatherings of leaders of major countries, such as through meetings of the G-7/8 and the G-20, now seem to provide the main platforms for finding internationally concerted solutions. It is clear that the G7/8 can no longer function as a credible global steering group. The London summit will be based on the G-20, though not fully restricted to G-20 members. Further, the main focus of the summit is now only on economic issues. While the G-20 process could well pave the way for a broader consensus, the United Nations can enable the engagement of the entire international community, providing a legitimate basis for the responses and reforms and ensuring these are aligned with broader sustainable development objectives.

12. **The UN system can contribute by assisting countries in improving and developing monitoring systems** that track the impact of the crisis, the effectiveness of policies to address it and the degree of alignment of these responses with achievement of the MDGs and sustainable development objectives (see also paragraphs 29 - 31 below).

13. **The functions and responsibilities of the United Nations Economic and Social Council will need to be strengthened** to ensure the coherence of a new global economic governance framework and provide multilateral responsiveness and legitimacy for global responses to emerging crises (see paragraph 28 below).

DEALING WITH THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

14. **Globally concerted action is now urgently required in four key areas,** balancing needs for immediate impact and longer-term development objectives:
    a) Coordination of macroeconomic stimulus packages
    b) Special financial support measures to developing countries
    c) Addressing systemic issues and reforming global economic governance mechanisms
    d) Monitoring, accountability and security

a) Coordination of macroeconomic stimulus packages

15. **Urgent fiscal and monetary stimulus is needed**: Failure to act quickly to address the global downturn will increase its depth and duration and the cost of recovery. Despite some massive interventions, the action taken thus far has proven insufficient to reverse the cause of events. At present, it is clear that policy makers can no longer solely rely on monetary policy measures and financial sector bailouts to prevent the global economy from falling into a spiral of contraction. While financial sector rescue operations should become more forceful to restore the flow of credit to productive sectors and while countries should use all remaining space for further monetary stimulus, clearly the main countercyclical action now must come from fiscal stimulus to reactivate economic activity worldwide and to curb employment losses. The latter is not only crucial to raise the level of expenditures in the global economy, but also to fend off a substantial rise in global poverty and the spread of social unrest.

16. **Without coordination, the stimulus may fall short of what is needed.** Though substantial, the fiscal stimulus packages put together by national governments so far seem to fall short of what is needed and would be unevenly distributed. Furthermore and crucially, despite the recognition that concerted action is needed, thus far little to no coordination of the fiscal stimulus has

taken place in practice. The lack of coordination in the size and timing of the implementation will limit the multiplier effects of the stimuli, thus reducing the impact on employment and economic growth. Some countries hesitate to take further action over concerns of possible negative repercussions in the medium run from widening of fiscal deficits and larger public debts. The severity of the financial crisis calls for policy actions that are commensurate with the scale of the problem, and should thus go well beyond any normal range of budgetary considerations. Looking ahead, the overall costs of widening fiscal deficit due to stimulus packages, if they can effectively reduce the depth and duration of the economic downturn and save employment, could well be smaller than the total economic and social costs of a depression.

17. **Immediate stimulus needs to be balanced with long-term investments in human development and a more sustainable economy.** Fiscal stimulus should be such that it provides immediate traction in order to restore consumer and business confidence and avoid major social costs. At the same time, the crisis provides an opportunity to align the fiscal stimulus packages with sustainable and equitable development goals:
    - This applies to developed countries where much of the stimulus could take the form of investments in infrastructure, technology development and production of renewable energy, and greater energy efficiency in the fight against climate change.
    - Similarly, developing countries should try and align new fiscal stimulus with long-term development goals. Increased public spending on infrastructure, clean technologies, agricultural development, sustainable natural resource management, education and health would help diversify their economic structures and reduce their dependence on a few commodity exports, and thereby help them meet key development goals, including achieving greater food security, addressing climate change and meeting the MDGs.

18. **The macroeconomic stimulus needs to be coordinated within a medium-term financing framework.** Both the financial rescue operations and stimulus packages will demand potentially large contributions from current and future tax payers and may involve large redistributions of wealth. The financing of the fiscal stimulus should therefore be transparent in terms of how the costs are expected to be distributed over time across countries and across population groups. International coordination will be required to avoid undesirable negative impacts of the way in which the fiscal stimulus is financed, including on exchange rates, global inflation and interest rates, the sustainability of public debt, and the global imbalances.[2]

[2] For instance, if as is to be expected a major part of the fiscal impulse is generated in the United States and this ends up in a large increase in US public debt or, alternatively, large issuance of dollars, this could precipitate, either way, a strong depreciation of the dollar. Given the dollar's role as major reserve currency, this may have highly disruptive effects on financial markets.

19. **The stimulus should not come at the cost of delivery on aid commitments.** As to bilateral aid, with the current financial crisis, and economic slowdown in most donor countries, there is a general fear that aid budgets will be cut as happened, for instance, after the recession in the early 1990s. However, donors have repeatedly pledged to deliver on existing aid commitments, including at the Doha Follow-up Conference on Financing for Development of November-December 2008. To confront the present crisis, more, not less aid will be needed, especially for the poorest developing countries. Accelerated delivery towards existing commitments can provide the necessary resources to also allow the poorest countries to engage in fiscal stimulus and avoid major social setbacks (see below).

20. **The stimulus packages should be free of protectionist clauses and avoid contributing to unfair trading practices.** Protectionism will be self-defeating and could prolong the worldwide recession, with especially damaging consequences for developing countries.

21. **Strong position should also be taken against the imposition of further restrictions on migration.** Although the precise impact of the crisis on international migration and remittances is still uncertain, there are already clear indications that many migrants have a high probability of losing their jobs and income with commensurate effects on the flow of remittances, which form an important source of income to many poor families in the developing world. The world community should ensure the crisis does not lead to a backlash against migrants in receiving countries and should avoid development in countries of origin is harmed even more that way through an even stronger drop in remittances.

b) Substantial financial support for developing countries is needed

22. **Substantial increases in compensatory financing, official development lending and assistance are needed for developing countries** to enhance their scope for countercyclical responses. The international community has been slow to recognize the crisis-related need for exceptional access to financing for developing countries. The IMF has expanded its compensatory financing facilities, but these have remained highly conditioned to undesirable pro-cyclical policy conditionality. The international donor community has pledged to meet aid commitments, but in practice aid budgets of bilateral donors are under political attack in many countries.

23. **What is needed is a compensatory and development financing plan for a total of \$1 trillion for 2009-2010** to meet needs of both middle- and low-income countries, and especially of the least developed countries amongst them, in order to enhance their countercyclical responsiveness and allow them to avoid having to cut necessary public expenditures. This plan should consist of two main components:

(1) $500 billion for enhanced short-term, compensatory financing:

24. According to the World Bank and the Institute for International Finance, private capital flows to developing countries declined by about $500 billion in 2008 from 2007 levels and a further decline by about $630 billion is forecast for 2009. The decline has been the result of among others a severe squeeze of trade credits, which is affecting trade and growth of developing countries directly. Well over $1 trillion in corporate, external debt in emerging markets and other developing countries will mature in 2009 and will need to be rolled over. As commodity prices and exports decline and income from worker remittances subsides, most developing countries will experience severe balance of payment problems. The World Bank estimates that 98 of 104 developing countries are expected to fall short of covering external financing needs, with an estimated external financing gap which could rise to $268 billion in 2009 alone, but may well be as high as $700 billion under an envisaged scenario of further declines in private capital flows and increased capital flight. For low-income countries alone, the IMF estimates that the balance-of-payments shock could amount to $140 billion in 2009.

25. While some developing countries have accumulated vast amounts of international reserves, these are unequally distributed (most held by China) and insufficient for most developing countries to cope with the magnitude of the external shock provided by this crisis.

26. To overcome these short-term external financing gaps, and allowing short-term debts to be refinanced and ensure trade credits can start flowing again, the following is needed for developing countries over 2009 and 2010.
    - **At least $500 billion in enhanced international liquidity for compensatory financing** will be needed to allow developing countries to refinance their sovereign debts as well as existing bank and corporate debts of their private sectors and accordingly unlock their domestic credit markets and regain access to trade credits and international capital markets.
    - The additional resources for compensatory financing could be mobilized through issuance of at least $250 billion in special drawing rights (SDRs)[3], complemented by the utilization of unused special borrowing facilities of the IMF and through the mobilization of reserves and resources accumulated in sovereign wealth funds from surplus countries.[4]
    - To ensure immediate accessibility to funds, the additional liquidity should be channeled through existing mechanisms, including the IMF and regional institutions. This will require closer collaboration between the IMF and regional institutions of financial cooperation.
    - **Adequate oversight of the usage of resources will also need to be established**, ensuring in particular that the compensatory financing is not

[3] Such SDR issuance could amount to $250 billion as has been proposed in the past, but was not backed at the time by the United States government.

[4] Japan has already lent $100 billion of its reserves to the IMF.

subject to the kind of pro-cyclical policy conditionality which is typically attached to existing mechanisms.

(2) *$ 500 billion in increased multilateral development lending and official development assistance:*

- **An additional $500 billion in enhanced long-term official financing** will be needed to cover fiscal revenue gaps (due to falling export revenues and falling growth) and provide developing countries the required space to protect social spending and finance fiscal stimulus packages. Spread over two years, this would amount to about 3 per cent *per year* of the combined GDP of developing countries (excluding China and major oil-exporting countries) to the worldwide stimulus.[5] As indicated, the fiscal stimulus programs should be aligned as much as possible with long-term development needs, for increased public spending on infrastructure, clean technologies, agricultural development, sustainable natural resource management, education and health to meet key development goals, including adequate job creation, achieving greater food security, addressing climate change and meeting the MDGs.
- **The increased resources should come through two windows:** $250 billion for increased multilateral development lending and another $250 billion through concessional loans and grants targeted at the poorest countries
- **The increase in development lending by $250 billion** could be mobilized through the multilateral development banks:
  - a) By optimizing use of available capital, the World Bank could make new development financing commitments for about **$100 billion**.
  - b) With a $60 billion replenishment of their capital and maintaining solid leverage ratios, regional development banks could expand development lending by about **$150 billion**.
- **The $250 billion in additional development assistance** would be targeted at low-income countries and could be mobilized as follows:
  - a) **$50 billion** could be mobilized by front-loading resources in the already replenished International Development Assistance (IDA) window of the World Bank and those in the concessional windows of the regional development banks.[6]

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[5] China and major oil-exporting developing countries with vast accumulated international reserves may not need the access to the additional financing. According to the UN forecasts, average developing growth (excluding China and major oil-exporters) may drop by 6 percentage points or more from the robust growth of the past few years. Assuming a multiplier effect of about 1.7 from well-designed fiscal stimulus packages, would imply that the stimulus should be about 3 per cent of developing-country GDP per year.

[6] The World Bank's concessional window (IDA) was already replenished by $30 billion in 2008 to cover three years of credits and grants. This could be frontloaded to make these resources available during 2009 and 2010. Equally concessional lending windows of regional development banks (ADB, AfDB, IDB and others) could be frontloaded to provide the additional $20 billion.

b) **$200 billion** can be mobilized through an acceleration of the delivery on existing ODA commitments.[7]

- These additional ODA resources could be channeled through existing bilateral channels and by enhancing aid provided through multilateral agencies, including the United Nations system. The World Bank's proposal for a "Vulnerability Fund" of the size of 0.7 per cent of the developed countries' stimulus packages (amounting to about $15 billion) might form a part of this broader proposal.
- Delivery on the additional ODA resources should follow through on donor commitments to improve aid effectiveness and improving the predictability of aid flows for recipient countries.

c) Systemic reform of the international financial architecture and global economic governance

27. As in the crises of the 1930s which led to the Great Depression, the systemic causes of the present crisis are ultimately based on fundamental weaknesses in global economic governance and overcoming these defects is the only genuine solution. These weaknesses underpin haphazard financial deregulation, the explosion of global imbalances and vulnerabilities, and irresponsible behaviour promoted by the international reserve system. Much more fundamental changes are needed to reform the international financial system in order to provide better safeguards that can prevent it happening again, and to create a framework for global economic governance in line with 21st century realities.

28. Given the existing systemic flaws, it is paramount that urgent progress is being made towards the design of a new international financial architecture and, more broadly, a new global economic governance structure:

- **Major deficiencies in international mechanisms of financial regulation and supervision must be urgently addressed**, such as to avoid excesses of the recent past which were at the root of the present crisis and safeguard international financial markets from recurrence of the problems that have emerged. Apart from deep reforms of existing regulatory frameworks, **strengthened international tax cooperation** should form a critical element of a more effective global system of financial regulation. The establishment of an international mechanism for sovereign debt restructuring and relief is also urgently needed. While urgent, it should be stressed that financial reform will only be part of the solution. It would be a mistake to limit attention to "fix" the financial markets, as these cannot be repaired fully as long as there are deeper problems in the global economy.

[7] At the 2005 Gleneagles Summit, the G8 committed to raise ODA to at least $160 billion per year (at 2008 prices) by 2010[7] (up from $103.7 billion in 2007). Meeting this commitment should increase existing aid flows by a total of about $115 billion over 2009-2010. Further delivery towards the agreed UN target of 0.7 per cent of their annual GNI could provide the remaining $85 billion needed over 2009-2010, which would bring ODA to about 0.4 per cent of GNI of OECD/DAC members.

- **Reform of the global reserve system**. A new global reserve system must be created which no longer relies on the US dollar as the single major reserve currency. The dollar has not proven to be a stable store of value, a requisite for a stable reserve currency. Also global instability and deficiencies the international financial institutions to address this instability have led many developing countries to accumulate vast amount of reserves on their own. This build up has contributed to the deflationary pressures to the world economy. A new system needs to be developed which allows for better pooling of reserves at the regional and international levels and which is not based on a single or even multiple national currencies, but which permits the emission of international liquidity (SDRs or an equivalent thereof) so as to create a more stable global financial system.
- **A fundamental reform of the governance structure of the Bretton Woods institutions.** At the Doha Conference on Financing for Development, member states already agreed that the Bretton Woods institutions must be comprehensively reformed so that they can more adequately reflect changing economic weights in the world economy and be more responsive to current and future challenges and to strengthen the legitimacy and effectiveness of these institutions. Beyond the rebalancing of voting power in these institutions, it is important to introduce a fundamental revision of their functions and equip them with the necessary resources, such that they can effectively safeguard global financial stability, coordinate macroeconomic policies and provide adequate long-term development financing.
- **Strengthening the United Nations Economic and Social Council.** Broader reforms of the global economic governance structure must be considered as well, including a strengthening of functions and responsibilities of the United Nations Economic and Social Council to ensure coherence between the financial architecture and the global governance frameworks for climate change, development, the multilateral trading system and new governance mechanisms for international financial regulation. A strengthened ECOSOC is further needed to provide **political legitimacy for global responses to emerging crises**. The urgency of action should not undermine inclusiveness in decision-making. The protection of the world's global goods – whether financial or climate stability – requires inclusive decision making. Discussions among groupings of countries play an important role, but choices – that affect each and every country – cannot be made by some on behalf of others. For effective decision-making smaller membership, but reflecting constituency-based representation for groups of countries, may be considered.

d) *Monitoring and accountability*

29. The world economy is in a state of great uncertainty and many did not see this crisis coming. The bold and globally concerted actions as proposed will require vast amounts of resources. The crisis as well as the mobilization of the

resources to combat it will have substantial distributional consequences. If the measures do not make visible impact within a reasonable time horizon and tax payers are insufficiently informed of how resources are being used, there is a danger of increased social unrest and threat to global security.

30. There is thus an **urgent need to take swift and synchronized actions to improve existing global monitoring and reporting systems** using economic, financial and sustainability indicators, based on but not limited to official statistics, which will:
- provide insight in vulnerabilities in the global economy at large (including financial sectors) and serve that way as early warning systems;
- identify which countries and population groups within these are most at risk to swings in the global economy;
- monitor and provide insight into how stimulus packages are being spent and financed and into the distributional effects of these;
- signal effectiveness of measures taken and provide information to facilitate decision-making to correct course when needed; and
- set new micro and macro-prudential standards for improved monitoring of the stability of the financial systems in collaboration with the International Accounting Standards Board (IASB) and regulatory agencies.

31. The UN system, in collaboration with Member States and relevant international agencies, could lead the coordination and development of such systems that should contribute to improved accountability of global public action.

Interactive Thematic Dialogue

On the Financial and Economic Crisis and its Impact on Development

25 – 27 March 2008

United Nations Headquarters, New York

(Provisional)

Programme

<u>25 March (Analysis of the crisis)</u>

10:00 a.m. Opening statement by the President of the General Assembly

Morning Panel - The crisis: origins, evolution, and systemic aspects
Moderator: H. E. Morten Wetland, Permanent Representative of Norway to the United Nations.

10:20 a.m. 11:20 a.m.
Presentation 1: Mr. Jomo Kwame Sundaram, Assistant Secretary-General. DESA.
Presentation 2: Ms. Jane Stewart, Special Representative to the United Nations. International Labor Organization (ILO).
Presentation 3: Ms. Alicia Barcena, Executive Secretary ECLAC. Regional dimensions of the crisis. Videoconference.

11:20 a.m. – 11:40 p.m.
Comments by:
- Mr. Andrey Denisov, First Deputy Foreign Minister of the Russian Federation.
- Prof. Mario Baldassarri, Senator, Chairman of the Committee on Finance and Treasury of the Italian Senate.

11:40 a.m. – 1 p.m.
Questions and answers and statements by Member States, groups of states, international organizations and other organs of the UN system. Two questions or statements by two representatives of civil society organizations.

Afternoon Panel: UN System Responses to the crisis
Moderator: Mr. Yu Yongding. Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences. Former Member of Monetary Policy Committee, People’s Bank of China. Member of the Commission of Experts of the PGA.

3:00 – 4:15 p.m.
Presentation 1: Mr. Ugo Panizza. Chief of the Debt and Financial Analysis Unit, Debt and Development Finance Branch, Division on Globalization and Development Strategies, United Nations Conference on Trade and Development (UNCTAD).
Presentation 2: Mr Selim Jahan, Director, Poverty Group, Bureau for Development Policy, United Nations Development Programme (UNDP).
Presentation 3: Mr. Jeffrey Lewis, Senior Advisor, World Bank.
Presentation 4: Mr. Ranjit Teja, Deputy Director of Strategy Policy and Review Department, International Monetary Fund.

Comments by: Mr. Martin Khor, Executive Director of the South Centre.

4:15 - 6:00 p.m. Questions and answers and statements by Member States and groups of states, international organizations and other organs of the UN system. Two questions or statements by two representatives of civil society organizations.

26 March

Morning Presentation.

Moderator: H.E. In Kook Park, Permanent Representative of the Republic of Korea to the United Nations.

10:00 – 11.00 a.m.
Introduction of the Recommendations. *Professor Joseph Stiglitz* (USA), Chairman of the Commission of Experts accompanied by Members of the Commission.

11.00 a.m.-1.00 p.m. Questions and answers and statements by Member States and groups of states and UN agencies. Two questions or statements by two representatives of civil society organizations.

Afternoon Panel.

Moderator: H.E. Mrs. U. Joy Ogwu, Permanent Representative of Nigeria to the United Nations.

3:00 – 3. 45 p.m.
Panel 1: Reform of International Institutions
Ms. Heidemarie Wieczorek-Zeul (Germany)
Mr. Jomo K.S. (United Nations)
Mr. François Houtart (Belgium)
Mr. Pedro Páez (Ecuador)

3:45 – 4:30 p.m.
Panel 2: Macroeconomic measures in response to the Crisis:
Mr. Jean-Paul Fitoussi, Chair (France)
Mr. Jomo K.S. (United Nations)
Mr. Robert Johnson (USA)
Mr. Yaga Venugopal Reddy (India)

Comments by: Mr. Jon S. Corzine, Governor of the State of New Jersey, USA (To be confirmed)

4:30 – 6:00 p.m.
Questions and answers and statements by Member States and groups and UN agencies. Two questions or statements by two representatives of civil society organizations.

<u>27 March</u>

Morning Panel.
Moderator: H. E. Claude Heller, Permanent Representative of Mexico to the United Nations.

10:00 – 10:30 a.m.
Panel 3: International Financial Architecture:
Mr. Yu Yongding, Chair (China)
Mr. Yaga Venugopal Reddy (India)
Mr. Benno Ndulo (Tanzania)
Ms. Heidemarie Wieczorek-Zeu (Germany)
Ms. Zeti Akhtar Aziz (Malaysia)

10:30 - 11.00 a.m.
Panel 4: Re-Regulating the Financial System
Mr. Robert Johnson, Chair (USA)
Mr. Yaga Venugopal Reddy (India)
Mr. Benno Ndulo (Tanzania)

11:00 p.m. – 12:45 p.m.
Questions and answers and statements by Member States and groups and UN agencies. Two questions or statements by two representatives of civil society organizations.

Closing
12:45 p.m.
Final remarks. *Professor Joseph Stiglitz*, Chairman of the Commission of Experts.

ORGANISATION INTERNATIONALE DU TRAVAIL
BUREAU AUPRÈS DES NATIONS UNIES

ORGANIZACION INTERNACIONAL DEL TRABAJO
OFICINA PARA LAS NACIONES UNIDAS

INTERNATIONAL LABOUR ORGANIZATION
OFFICE FOR THE UNITED NATIONS

Jane Stewart
Special Representative to the United Nations and
Director

24 March 2009

Excellency,

In preparation for the Extraordinary Interactive Thematic Dialogue on The World Financial and Economic Crisis and Its Impact on Development which is to take place from 25 to 27 March 2009, it is my privilege to draw your attention to the attached executive summary of the document entitled: *"The financial and economic crisis: A Decent Work response"*. The complete paper, which can be accessed on the website of the President of the General Assembly, has also been submitted to the ILO's Governing Body Committee on Employment and Social Policy as well as to the High-level Tripartite meeting on the Current Global Financial and Economic Crisis.

This contribution will serve as a background to the discussion on the ILO's analysis of the origins and impacts of the international financial crisis which will be presented on 25 March at the above-mentioned thematic dialogue.

Please accept, Excellency, the assurances of my highest consideration.

Jane Stewart
Special Representative to the United Nations and
Director

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UN GENERAL ASSEMBLY

Extraordinary Interactive Thematic Dialogue on The World Financial and Economic Crisis and Its Impact on Development

AN ILO DISCUSSION PAPER

The financial and economic crisis: A Decent Work response [1]

[1] This paper is also being submitted to the ILO's Governing Body Committee on Employment and Social Policy as document GB.304/ESP/2 and to the High-Level Tripartite meeting on the Current Global Financial and Economic Crisis as document HTM/1.

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Executive Summary

The global crisis is deepening…

1. The world economy has been significantly affected by the financial crisis and prospects are the worst since the Great Depression. Already, the largest developed countries, notably those where the crisis originated, have entered into recession. Spill over to other countries was initially small, but several emerging economies are now being hit hard – assumptions about a "decoupling" of these economies have indeed proved wrong.

2. Developing countries too are facing the effects of the crisis, which will disrupt – and in some cases reverse – the achievement of Millennium Development Goals, including decent work for all. This is of particular concern given that, even in the pre-crisis period, growth patterns in certain regions, notably in Africa, led to only negligible reductions in poverty. Decent living and working conditions still remain out of reach for large numbers of people.

3. Importantly, the crisis is spreading throughout the real economy by means of three mutually-reinforcing transmission channels, namely: the limited availability of credit for working capital, trade finance and viable investments in the real economy (the credit crunch); cautious spending decisions, leading to lower output, employment and prices, in turn affecting confidence among consumers and investors (the vicious cycle of depression); and international trade and investment linkages and remittance flows (the globalization channel).

... and entails a risk of a prolonged labour market recession ...

4. The consequences of the crisis on labour markets have been visible since 2008, especially in the United States where the crisis originated. At the global level, after four years of consecutive declines, the number of unemployed increased in 2008 by 11 million. As the crisis continues to spread and job losses mount, worldwide unemployment could increase by an additional 40 million by the end of this year.

5. The bleak labour market picture affects certain groups disproportionately – notably women, migrant workers and youth. In some countries, the financial sector, construction and automobiles are suffering the most. In general, export-oriented sectors, which in many developing countries are major providers of formal jobs, notably for women, face the prospect of rapidly shrinking world markets. And the impact of the crisis on labour markets will go beyond job losses. In particular, the incidence of informal employment and working poverty will rise, aggravating pre-existing challenges.

6. The biggest risk is of a prolonged labour market recession. Lessons from past financial crises show that the labour market tends to recover only four to five years after the economic recovery (which is not expected before the end of 2009). This is because massive rises in long-term unemployment and greater labour market "informalization" – exacerbated by return migrants and large-scale reverse migration from urban to rural areas – are very difficult to reverse. If these trends take root, the negative effects of the

crisis will be long-lasting, thus yielding significant social hardship and depriving the economy of valuable resources.

... threatening social stability

7. Social hardship will be heightened in developing countries where social protection is often limited. But even in emerging economies and a number of developed countries, most new jobseekers do not receive unemployment benefits. The result is that millions of workers will be left without adequate support.

8. Pension systems are under severe strain as a result of the collapse of capital markets. Private pension funds have recorded substantial losses on their investments. Though the trends are often presented in overly technical language, one thing is clear: pension entitlements for workers who rely on such funds have been cut by over 20 per cent, on average. In some countries, even retirees have been left with the prospect of lower pension benefits. Importantly, well-designed public pension systems have been much less affected than private funds. This has motivated a policy shift in the stance of certain international organizations, which now advocate greater focus on more stable, security-oriented public pension systems. This is a much-welcomed development, though the damage has already been done and will be difficult to repair.

9. Finally, there is concern that the crisis is affecting all groups, while the gains of the pre-crisis expansionary period had been distributed unequally.

10. In short, a social crisis is looming large and can only be averted if adequate action is taken promptly.

Countries have attempted to address the crisis through the adoption of massive financial rescue measures and the announcement of fiscal stimulus packages…

11. Much of the focus to date has been on stabilizing financial markets and attempts to restore credit liquidity. At the same time, to stimulate the economy many countries have announced fiscal rescue packages – cutting taxes and boosting spending – of varying sizes. Several countries have also taken some action to mitigate the labour market and social consequences of the crisis. However, the amount committed for financial rescue measures has been for the most part far in excess of fiscal tools deployed to stimulate demand, output and employment.

...but the plans have not succeeded so far ...

12. It is commendable that countries have reacted so quickly, given the time lag for these packages to reach the real economy. Nevertheless, the impact of the measures has been limited to date. This is because, as evidenced from the over 40 rescue and stimulus plans assessed for the purposes of this paper, the transmission mechanisms through which the crisis is spreading have not been fully addressed. And the measures have often failed to tackle the structural imbalances that lie behind the crisis.

… because the credit system has not been revived…

13. First, rescue measures to banks, though of unprecedented magnitude, have not revived bank credit. To avert the risk of systemic collapse, developed countries have rescued financial institutions through capital injections, credit guarantees and sometimes outright assumption of bad loans. Indeed, protecting banks' solvency and restoring the availability of credit to enterprises and households was rightly regarded as a pre-condition to avoid a total collapse of the financial system, with unpredictable consequences for the real economy. However, access to bank credit remains limited.

... fiscal packages do not focus sufficiently on decent work and are not coordinated, thus failing to boost the economy…

14. Second, fiscal stimulus measures announced by governments are generally on a lower scale than rescue support to banks. In addition, they mostly do not focus sufficiently on employment and social protection. For instance: only a handful of countries have announced labour market initiatives; infrastructure programmes do not adequately take into account the need to reinforce the existing capacity of businesses and skills supply – so that part of the infrastructure spending may result in higher prices, rather than higher production and jobs; and some tax cuts will end in higher savings rather than higher demand, output and jobs. The measures moreover involve only limited social dialogue with employers and unions and lack coordination across countries.

15. Lack of international coordination obviously diminishes the overall effect of the stimulus measures. But it also makes each individual country reluctant to move faster than its trading partners, given the international linkages. As a result, practical implementation of the fiscal packages may be postponed further, aggravating the vicious cycle of depression.

… world markets face the risk of inward-looking solutions, competitive devaluations and wage deflation…

16. Third, world markets are affected by the credit crunch (which dries up trade finance available to enterprises) and face the risk of inward-looking solutions and protectionist responses. The repercussions for developing countries, which rely so heavily on world markets, would be especially acute. This is why the multilateral system should remain vigilant vis-à-vis the mounting pressure to support strategic sectors like automobiles. Likewise, attempts to overcome the crisis through competitive currency devaluations would be counterproductive.

17. Generalized wage deflation to protect individual economies would aggravate the crisis even more than a wave of competitive devaluations. Indeed, wage deflation would deprive the world economy from much-needed demand and would also seriously undermine confidence. Open market policies, which are so crucial to the recovery, would also face a risk of backlash if workers perceive the measures as unfair.

… little attention has been devoted to the development dimension…

18. Fourth, inadequate attention has been given to the development perspective. The social impacts of the crisis in developing countries are exacerbated by the fact that the majority

of workers and small businesses do not have basic social security. It is expected that between 40 and 50 per cent of men and women globally will not be able to earn enough to lift themselves and their families above the two US dollars a day poverty line in 2009.

19. Moreover, many developing countries lack the capacity to undertake massive public investments. Already a number of countries are facing sizeable fiscal and current account deficits on the heels of the food and fuel price crisis of mid-2008. If the gap between countries widens even further as a result of varying capacities to respond to the crisis, global imbalances and inequalities will intensify.

20. Traditional International Monetary Fund (IMF) packages to support countries that undergo balance of payments crises are simply not adapted to the situation. Such packages were based on an approach that assumed countries faced local crises, for which the countries involved themselves had the main responsibility. The current crisis, however, is global and originates in the developed world. A multiplication of traditional rescue packages would further aggravate the decline in world demand and perpetuate the global crisis. This is why a new mechanism, which would coexist with IMF rescue packages, rather than replace it, is needed.

… and the structural causes of the crisis have not been tackled

21. Fifth, the stimulus measures have, so far, not been deployed with a view to ensuring that global growth is more equitable and sustainable in the medium to longer term. Global imbalances, decent work deficits and inequalities have been a significant contributor to the crisis. Likewise, reflecting poorly regulated financial markets, the real economy has been subject to pressure to raise returns in the short run, sometimes to the detriment of workers' incomes and the long-term interests of sustainable enterprises. It is vital to tackle the root causes of the crisis to support the recovery, reduce the risk of another major systemic crisis and promote a sense of fairness. Reverting to the "status quo" is not an option.

What is needed is a global jobs pact

22. Moving ahead with the Decent Work Agenda is crucial to supporting the economic recovery, averting the labour market and social crises and promoting social cohesion on the measures. In the global crisis context, this is best done through a global jobs pact.

23. A *global* approach is needed because the measures, to be effective, need to avoid beggar-thy-neighbour solutions to a crisis which is global in nature. The emphasis on *jobs* comes from evidence provided in this paper that it will not be possible to reactivate the economy in a sustainable manner unless greater emphasis is placed on decent and productive employment for women and men, well-designed social protection and workers' rights. Measures are best implemented through social dialogue in countries, but greater cooperation at the international level can also have mutually-reinforcing benefits – thus the need for a *pact*.

24. The global jobs pact would build on the ILO's Global Employment Agenda and the November 2008 statement by the Officers of the ILO Governing Body. In essence, the

global jobs pact seeks to support economic recovery through decent-work friendly policies, reduce the risk that the crisis spreads further across countries and pave the way for a more sustainable, fairer globalization. This is how.

25. To ***restore credit***, governments could consider:

- Making financial support, such as government's assumption of toxic assets, conditional on: beneficiary banks providing new credit for viable projects of businesses and individuals; and limitations to managers' pay and dividend policy, so that government support does not miss the target of reactivating credit.
- Providing credit lines and direct access to government loans to small businesses (important drivers of innovation and employment growth) so they can maintain operations (and seize potential new opportunities) until demand is restored.

26. ***Fiscal stimulus packages would provide a much stronger boost to the economy and jobs, while also proving cheaper than current packages,*** if the following conditions were met:

- Ensuring that infrastructure, construction and housing projects leverage capacity among existing businesses by: giving small and medium-sized enterprises (SMEs) support to take advantage of new opportunities; ensuring that workers have the skills to respond to new requirements; and promoting the rural and agricultural dimensions of the projects, which are crucial for developing countries as they would help boost domestic economic and job dynamism and attenuate the looming food crisis.
- Given the lags in launching infrastructure, construction and housing projects, it would be helpful to: provide support to existing jobs in viable firms through shorter working hours, partial unemployment benefits and training; reduce labour taxes on low-wage employment; and enhance social protection through well-designed programmes that support aggregate demand and are consistent with work incentives. This could include conditional cash transfers to enhance access to education and health services, and unconditional transfers in countries where poverty is widespread and administrative capacity is limited. More structural measures are also needed however, so that social protection becomes broad-based.
- For job losers and new entrants who do not find jobs, the following measures proved useful in earlier crises: putting in place at least minimal unemployment benefits or employment guarantees for those not able to access income support (experience from the Asian crisis shows successful performers overcame the crisis partly through these new, cost-effective schemes); active labour market programmes and training administered through solid, well-resourced public employment services (evidence shows that these services, if well functioning, are crucial at times of crisis and are cost-effective relative to other measures); and specific programmes and approaches to vulnerable groups, notably women who return to the labour market after maternity leave, youth, who could also be encouraged to stay longer in education, and migrant workers.
- To the extent that specific industrial sectors need support, such support should be: subject to strict social and environmental conditionality; and targeted and coordinated globally, consistent with international trade agreements.

- Enhance fiscal space, administrative capacity and technical support to developing countries in the event of global crises, possibly through the creation of a global jobs fund. Unlike the IMF rescue packages, this fund would be anti-cyclical. The global jobs fund would not be subject to cuts in social spending and wage deflation (which not only depress the domestic economy but also affect neighbouring countries, exerting further downward pressure on world demand). Recipient countries could take advantage of ILO expertise in developing the various dimensions of the global jobs pact. They would engage social partners in the design of the measures. Repayment of the fund's loans, possibly larger in scale than traditional rescue loans, would be made easier because the system is anti-cyclical in nature, and thus supports the global recovery, and is designed to promote domestic economic capacity.

27. ***Avoiding wage deflation through coordinated systems of collective bargaining and protecting workers' rights*** would not only provide adequate support to victims of the crisis, but would also ensure a timely demand stimulus and pave the way for a more sustainable economy. As such, the global jobs pact would also comprise the following measures:

    - Strengthening respect for core workers' rights, as this would be both socially desirable and economically efficient to achieve more balanced income developments.
    - Building the capacity of social partners for dialogue and reach agreements at various levels so that wages for the economy as a whole grow in line with productivity developments (and not below them as was the case over the past two decades).
    - Guaranteeing the purchasing power of minimum wages, so that they act as anchor to all wages.
    - Avoiding wage deflation to support global demand and reduce trade tensions.

Global policy coherence for shared prosperity and development:

28. Now is the time to enhance cooperation among key international organizations. This is key to speed up the recovery. Indeed, inward-looking solutions would be counterproductive. More fundamentally, the crisis is global and multi-faceted, so no organization or country is equipped to address all its dimensions. This is why the ILO has reaffirmed the importance of fostering greater cooperation among national governments, international organizations, and other stakeholders in support of a stronger, cleaner and fairer economy. International partners can increase coherence between financial, trade, social, environmental and development goals. This also implies a reprioritization between these goals, to:

    - ensure that the financial system serves the real economy and social development, through a deep reform of the financial architecture and the implementation of executive compensation packages that are reasonable and geared towards real performance;
    - re-balance the globalization process, as stated in the ILO Declaration on Social Justice for a Fair Globalization (the Social Justice Declaration), and in particular address the decent work gaps, and excessive income inequalities as well as the

growing incidence of informal and non-standard employment that developed during the pre-crisis period;

- pave the way for a green economy, given that future spending will be limited by the need for governments to tighten budgets so as to repay mounting public debt after the economy recovers. Importantly, green technologies tend to be more job-rich than their CO_2-intensive counterparts – hence the Green Jobs agenda; and
- ensure that official development aid is not affected by the crisis and establish a new mechanism such as the global jobs fund, to complement existing measures and support adjustment of emerging and developing countries at times of crisis.

29. Debates at the G20 could offer an opportunity to discuss these issues, as well as the global jobs pact. In addition an exchange of good practices could take place at the ILO, so that countries benefit from each other's experiences and take advantage of the expertise developed at the ILO.

30. In sum, responses to the crisis must *not* be piecemeal in nature and rolled out temporarily, only to revert back to "business as usual" as soon as possible. The challenge now is to respond to the current crisis by putting in place measures that pave the way for a better pattern of growth and development.

Introduction

31. What started as a mortgage crisis in the United States in the latter half of 2007 has now developed into a global economic crisis, bringing with it unprecedented labour market and social challenges across advanced, emerging and developing countries.

32. The objective of this paper is to provide evidence-based policy analysis of how ILO members can best mitigate the challenges facing enterprises and workers. The first section of the paper reviews recent developments, discusses the origins of the crisis and how the damaging effects have spread from developed countries to other parts of the world, and from the financial economy to the real economy, employment and society.

33. The second section examines current international and national responses to the crisis, including financial and fiscal policy measures, labour market initiatives and social dialogue. The aim of this section is to assess the breadth and depth of the responses and identify potential gaps.

34. In building upon the lessons learned and measures taken to date, the third section of the paper examines the key ingredients to overcoming the crisis, and the role of the ILO in addressing the challenges.

35. The last section discusses how best to respond to the crisis through measures that support a recovery while meeting the longer-term goal of achieving a more sustainable and equitable pattern of development, as provided in the Social Justice Declaration.

I. Crisis spreads worldwide and entails risk of prolonged social crisis

The largest developed countries, notably those where the crisis originated, have already entered into recession …

36. The global economy is experiencing the worst economic crisis since the Great Depression. What began as a financial crisis when the housing market in the United States turned sour has now expanded into a global meltdown, wiping away trillions of dollars of financial wealth, putting the real economy at grave risk of prolonged recession, and causing significant job losses and widespread social hardship.

37. The IMF predicts that world output will grow at 0.5 per cent this year, the lowest rate since the Second World War (Table 1). In comparison, in 2007 and 2008, world output grew by over 5 per cent and 3.4 per cent, respectively. The European Union (EU), Japan, the United States and other large developed economies have already entered into recession or are on the brink of doing so. The UN's Department for Economic and Social Affairs (UNDESA) has confirmed the IMF's bleak economic prospects for 2009. And private-sector analysts such as the Deutsche Bank paint an even direr scenario, with world output actually falling in 2009.

Table 1. World Economic Outlook*

	IMF		Deutsche Bank	UNDESA
	2008	**2009**	**2009**	**2009**
World output	3.4	0.5	-0.8	1.0
United States	1.1	-1.6	-2.7	-0.9
Euro Area	1.0	-2.0	-3.0	-0.7
Japan	-0.3	-2.6	-7.6	-0.3
Brazil	5.8	1.8	1.2	2.9
China	9.0	6.7	7.0	8.4
India	7.3	5.1	4.8	7.0
Russian Federation	6.2	-0.7	-2.4	4.8
South Africa	:	:	:	2.5
Africa	5.2	3.4	:	4.1
ASEAN-5	5.4	2.7	:	:
Central and Eastern Europe	3.2	-0.4	:	:
Western Hemisphere	4.6	1.1		
Middle East	6.1	3.9	:	:

* IMF and UNDESA forecasts are from January 2009 and Deutsche Bank from 25 February 2009.
Source: IMF, Deutsche Bank and UNDESA.

…and the crisis is now spreading to the rest of the world…

38. Spill over to emerging and developing economies was initially small, but the crisis has now spread worldwide and from financial markets to the real economy through a number of transmission mechanisms (Box 1).

Box 1. **The crisis: causes and transmission mechanisms**

The crisis has been brought about by a combination of inappropriate financial regulations, excessive risk-taking of certain financial intermediaries and inefficient remuneration practices of bank managers and traders. But it is the interaction between these financial factors and global imbalances that lies at the heart of the crisis:

- Since the early 1990s, significant savings-investment imbalances built up. This is partly the result of export-oriented growth strategies in some countries, and insufficient savings in others. Lack of exchange rate adjustments contributed as well.
- Within countries, income inequalities grew significantly since the early 1990s. Stagnating wages and incomes for a majority of workers in some countries spurred demand for credit to sustain consumption possibilities and housing investment decisions. Interestingly, a rise in the share of over-indebted households has been observed in all the countries where income inequalities have increased.
- This was made possible by lightly regulated financial practices that allowed excessive debt accumulation and focused on short-term returns (because of skewed compensation packages) rather than long-term investments in the real economy. When housing markets reached a turning point and interest rates rose, over-leveraged low-income households defaulted on payments and foreclosures rose significantly. As the value of the assets plummeted, banks had to finance foreclosures, and effectively stopped lending to each other, causing liquidity to dry up substantially.[2] In short, financial markets have tended to operate to the detriment of labour market stability and sustainable enterprises.

The crisis then spread to the real economy, and beyond developed countries, through three channels.

First, the crisis spread through the financial system via the process of “securitisation” of “toxic assets”. Direct exposure to toxic assets led to some localized bank failures, but more broadly, inter-bank credit was affected and as a result, the volume of new credit available to the real economy declined. Even businesses with a long record of creditworthiness have had credit lines cut and have had difficulty selling their bonds. This abrupt freezing up of the normal credit lines needed for trade, coupled with the inability of companies to raise capital for seemingly profitable business opportunities and investment plans, created the so-called “credit crunch”.

Second, over and above the credit crunch, the crisis is gaining its own dynamics in the real economy through the confidence channel. Consumers and investors lack confidence and postpone their spending decisions. This affects firms’ prospects and leads to job losses, further aggravating confidence.

Third, the crisis is spreading worldwide through international linkages, so even countries with

[2] This issue is discussed in detail in ILO: *A global policy package to address the global crisis*, Policy Brief, International Institute for Labour Studies (IILS), Geneva, 2008.

relatively healthy financial systems are being affected:

- World trade is estimated to contract by 2.8 per cent in 2009 after growing at an average annual rate of 7.8 per cent for the last three years.[3] This has dire consequences for economies around the world, especially the export-led economies of Asia and Latin America. Moreover, global trade activity is also negatively affected by the scarcity of trade financing.

- Some trade prices, notably for oil and other commodities, declined significantly as a result of the recession. As such, oil and gas producers like Mexico, Middle Eastern countries, the Russian Federation and the Bolivarian Republic of Venezuela face a sudden reduction of export revenues. Likewise, declines in prices of metals such as nickel, lead and zinc have deeply affected countries such as Australia, Brazil and South Africa. Lower commodity prices – though improving the terms of trade for importing countries – have not outweighed the other negative forces at work.

- Foreign direct investment and other private capital flows are affected as well. In particular, private capital flows to emerging economies are expected to fall to $165 billion in 2009. From the high of $929 billion in 2007, this represents an unprecedented drop of 82 per cent.[4] This has implications for development, since one third of growth in emerging countries comes from investment.[5] Reduced flows of capital may have a dramatic effect on countries with large current account deficits and with a limited ability to borrow from abroad.

- It is likely that, for the first time in decades, remittances will fall, impacting the economic security of households around the globe. Remittances represent more than 10 per cent of GDP in over twenty countries, and in some cases as much as 24 per cent.[6] For many countries, remittances are larger than the amount received in Official Development Assistance. The negative impact of falling remittances on the developing world could be in the order of $3 billion per year.[7]

- Although donor countries have committed not to reduce development aid in several international fora, this commitment might eventually come under pressure in view of declining outputs in major industrialised countries.

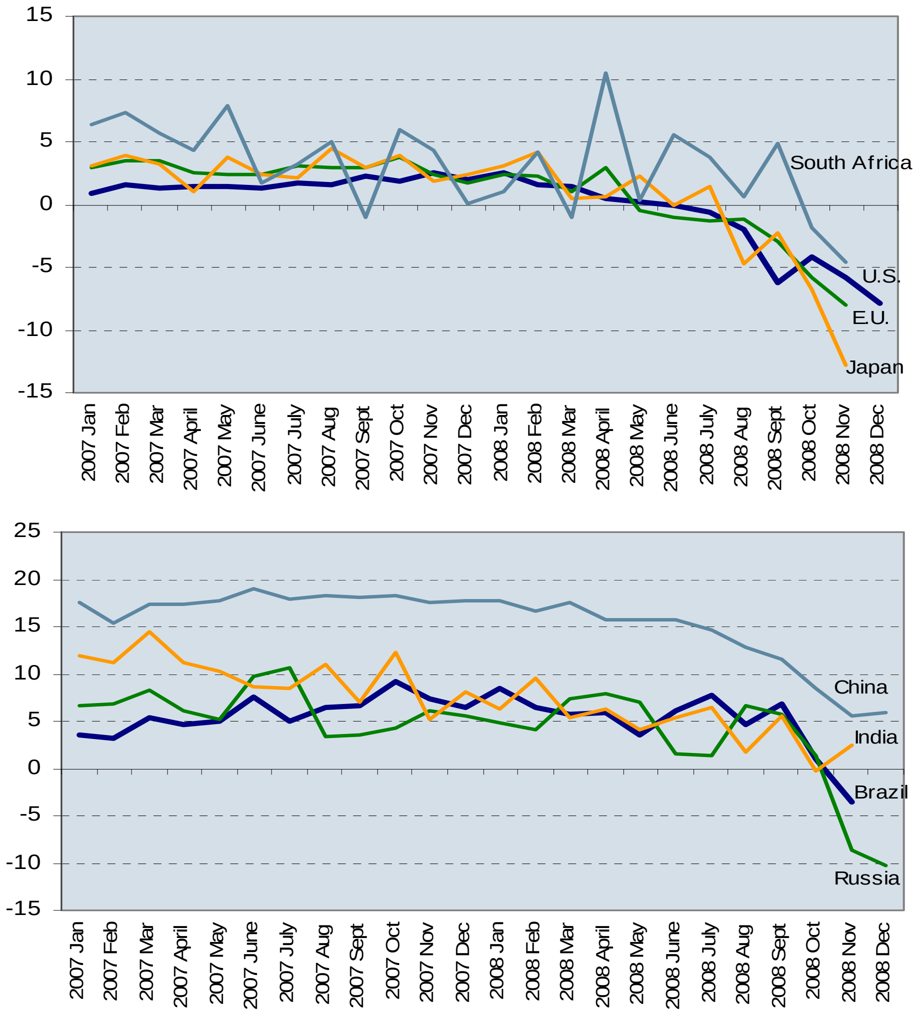
39. Large emerging economies are being hit hard by the crisis – assumptions of a "decoupling" of these economies have proved wrong. During the second half of 2008, industrial output slowed significantly and even contracted in some large emerging economies (Figure 1).

40. Other emerging and developing countries are also being affected. There is a risk that the development path will be seriously disrupted and in some cases reversed. This could compromise the attainment of the Millennium Development Goals, notably "full and productive employment and decent work for all, including women and young people".

[3] World Trade Organization: *Annual Report*, 2002.
[4] Institute of International Finance: *Capital Flows to Emerging Market Economies*, 27 January 2009.
[5] UNCTAD: *Trade and development report: Commodity prices, capital flows and the financing of investment*, 2008.
[6] World Bank: *Migration and Development Brief*, 29 November 2007.
[7] Under the assumption that remittances fall 2 per cent globally – in line with the estimated decline in Latin America (Inter-American Development Bank: *IADB estimates of 2008 remittance flows to Latin America and the Caribbean*, October 2008).

Decent living and working conditions still remain out of reach for a large number of people.

Figure 1. **Monthly change in industrial production (percentage)**



Source: World Bank.

…with severe impacts on certain sectors

41. Certain sectors are being disproportionately affected by the crisis. The effects on financial services and construction – the sectors at the epicentre of the crisis in developed countries – have been immediate and profound.[8] In a second round, those sectors most affected by the credit squeeze and confidence effects, like automobile production, were hit.[9] Export-oriented activities, tourism and commodity sectors are now suffering from

[8] See GB.304/STM/2/2 and V. Escudero: *Effects of the Crisis on the Financial Sector: Trends and Policy Issues*, Discussion Paper, IILS, ILO, forthcoming 2009.

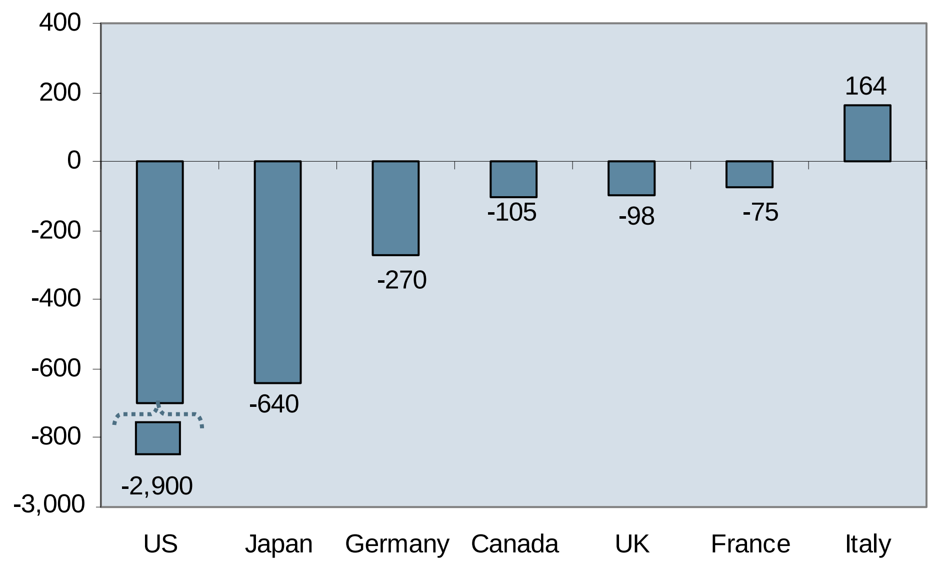
[9] Two-thirds of cars in the world are purchased with credit. However, it is important to note that even before the current crisis, the automotive sector was facing a number of challenges, including decreased demand for relatively high-profit vehicles due to volatile fuel prices and geographical relocation of some operations to areas with low labour costs. See GB.304/STM/2/2.

rapidly falling world demand and declining prices. The impact on developing economies that rely heavily on a narrow, commodity-based export sector, is dramatic.

Global unemployment rose in 2008 and employment levels have declined significantly in advanced economies…

42. As growth rates declined in 2008, the effects on the labour market started to be felt. After four years of consecutive declines, the global unemployment rate increased to 6 per cent in 2008, up from 5.7 per cent in 2007, and the number of unemployed rose by 11 million.[10] The impact was immediate and particularly severe in the United States, where employment losses started in early 2008 and have continued to mount since. Similar trends are present in Japan (Figure 2). In European countries, job losses have been contained to some extent due to recourse to shorter hours or partial unemployment benefits. However, even there, recent indicators suggest significant increases in unemployment.

Figure 2. **Employment declines in 2008 in the G7 (000s)**



Source: International Institute for Labour Studies (IILS) estimates based on national sources.

…with already visible impacts on emerging and developing countries...

43. In other countries, the job losses stemming from the crisis have only just begun and so the full extent of the impacts on labour markets may not be felt for some time. Nevertheless, there are early and clear indications that the crisis is impacting labour market and social conditions in emerging economies and developing countries:

- Following job losses in factories on the industrialized eastern coast of China, more than 20 million workers have reportedly returned to their residential rural areas.[11]
- During the last quarter of 2008, employment in eight export-oriented sectors in India (mining, textile and textile garments, metals and metal products, automobile, gems and jewellery, construction, transport and information technology) fell by over 3 per cent.[12]

[10] ILO: *Global Employment Trends,* January 2009.
[11] China national statistics, Ministry of Agriculture.

- The South African economy may lose a quarter of a million jobs as a result of the crisis and this is likely to undermine government plans to cut the unemployment rate to 14 percent by 2014.[13]
- Reflecting a sudden deterioration in the economic outlook, Central and Eastern European countries are experiencing a dramatic reversal of earlier, hard-won employment gains.
- Significant job losses have been recorded in developing countries that rely heavily on a narrow export base. For instance, in Africa, employment levels in commodity production and tourism have declined significantly in recent months.

44. In these countries, job losses will exacerbate challenges of employment informality and working poverty. In the absence of income support alternatives, job losers either move back to rural areas or take up informal jobs in the urban economy.[14] This has started to happen, according to an ILO report.[15] For instance, a reversal in rural-to-urban migration flows has been noted in China and, in Africa, workers who had formal jobs in export-oriented sectors have been pushed to the informal economy where they will earn lower wages. As a result, between 40 and 50 per cent of the world's working men and women in 2009 are not expected to earn enough to lift themselves and their families above the $2 a day per person poverty line.[16]

… and disproportionate effects on vulnerable groups such as women, youth and migrant workers

45. Groups that were already in a vulnerable position before the crisis will be disproportionately affected, while temporary and migrant workers are also usually not protected by collective bargaining agreements.[17]

46. The crisis is already having differentiated employment and social impacts from a gender perspective. Many of the job losses to date in advanced economies, especially the United States, have been in male-dominated sectors such as finance and construction.[18] However, in many developing countries, women are often in more precarious employment situations.[19] In particular, the concentration of women in export-oriented enterprises in emerging and developing countries brings a number of acute labour market challenges (Box 2).

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[12] C.P. Chandrasekhar; J. Ghosh: "Asian face of the global recession", in *The Hindu Business Line* 10 February 2009.
[13] N. Seria; M. Cohen: "Manuel Cuts South African Growth Forecast to Decade Low of 1.2 per cent", in *Bloomberg.com*, 11 February 2009.
[14] G. Betcherman; R. Inslam (eds.): *East Asian Labour Markets and the Economic Crisis*, World Bank, 2001.
[15] ILO Regional Office for Asia and the Pacific: *The Fallout in Asia: Assessing labour market impacts and national policy responses to the global financial crisis*, prepared for the forum Responding to the Economic Crisis – Coherent Policies for Growth, Employment and Decent Work in Asia and Pacific, Manila, 18-20 February 2009.
[16] ILO: *Global Employment Trends*, January 2009.
[17] The impact on vulnerable groups varies by country and time period under consideration (see for example, ILO: *Global Employment Trends for Women*, March 2008).
[18] Of the 2.9 million jobs losers in the United States in 2008, 2.3 million were male.
[19] ILO: *Global Employment Trends for Women*, March 2008.

Box 2. Impact of the crisis on women's employment[20]

The crisis has already hit major exporting industries dependent on American and European markets, such as labour-intensive sectors of developing countries. This includes clothing, footwear and processed foods, as well as micro-circuits and electronic products. Since women make up the majority of the workforce in these sectors, their labour market position has worsened considerably.

More generally, women are often regarded as a flexible reserve, to be drawn into the labour market in upturns and expelled in downturns.[21] Women are also over-represented among casual and temporary employment, contract labour and home workers. They also tend to earn lower wages than their male counterparts and the crisis is likely to worsen the situation in this regard.

47. Youth are facing considerable difficulties entering the labour market.[22] This comes on top of an already fragile situation for youth in both developed and developing countries. Even during the previous period of economic expansion, most economies fell short of creating enough decent and productive jobs for young people. Between 1997 and 2007, the number of unemployed youth rose by 8 million.[23] Moreover, a lack of decent work opportunities at an early age may permanently compromise the future employment prospects of youth. The relative disadvantage of young workers is even more pronounced in developing countries.[24]

48. As employment losses mount, migrant workers are particularly vulnerable and often among the hardest hit, due in part to their low bargaining position (especially among newly arrived migrant workers). Evidence from past crises reveals that for the most vulnerable migrant workers, especially women and those in irregular status, this often translates into significant job loss. For those able to maintain employment, a serious deterioration in working conditions is often registered.

The prospects are for a continued deterioration in labour market and social conditions…

49. The global number of unemployed persons could rise by 20 million in 2009.[25] If the outlook worsens to the point where increases in unemployment match the magnitude

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[20] A. King-Desjardin; J. Owens: *The global economic crisis: impacts and responses from a gender perspective*, ILO, forthcoming 2009.

[21] Studies of economic recessions in several developed countries in North America, Europe and Asia show that women's employment moved pro-cyclically, and significantly more pro-cyclically than men's (J. Rubery (ed): *Women and Recession*, Routledge & Kegan Paul, London, 1988). In addition, women's integration into the workforce in the 1980s was generally associated with their providing forms of labour market flexibility (G. Standing: "Global feminisation through flexible labour," World Development, Vol. 17, No.7, 1989).

[22] For example, in Spain, during the fourth quarter of 2008, employment decreased for most age groups, but the drop, at 10 per cent, was particularly severe for 20-24 year olds.

[23] ILO: *Global Employment Trends for Youth*, October 2008.

[24] *Ibid.*

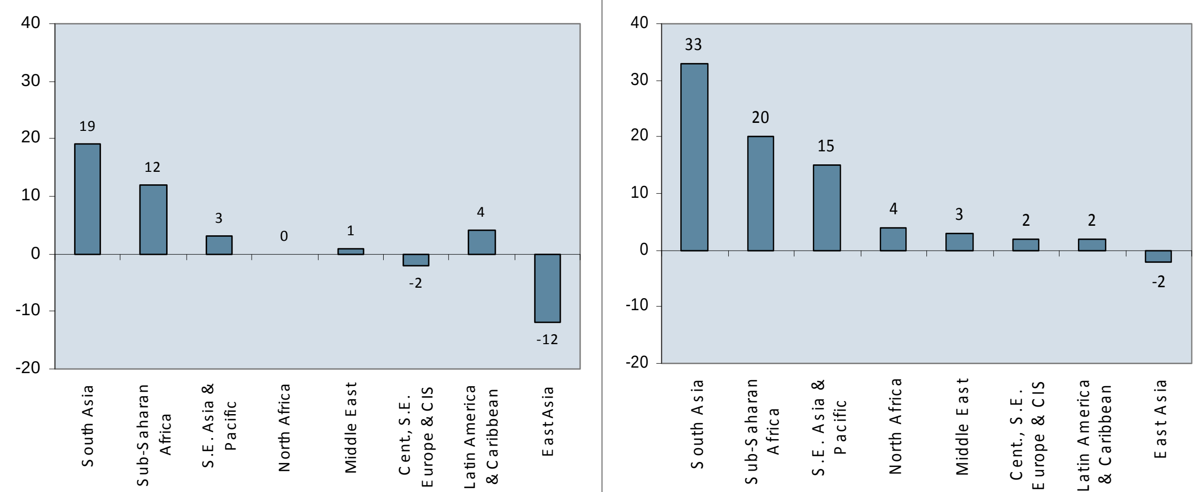
[25] ILO: *Global Employment Trends*, January 2009. Scenario 2: Projection on the historical relationship between economic growth and unemployment at times of crises in each economy; IMF revised estimates for economic growth, November 2008.

witnessed in the 1990s, then unemployment could rise by 50 million, bringing the global unemployment rate above 7 per cent.[26]

50. Likewise, vulnerable employment, as measured by own-account workers and contributing family workers, is expected to rise by some 25 million (Figure 3, Panel A). The majority of the increase is expected to occur in South Asia and Sub-Saharan Africa.

Figure 3. Projected increase in vulnerable employment and working poverty, (millions, change from 2007 to 2009)

Panel A. Vulnerable Employment | Panel B. Working Poor (<$2/day)



Source: ILO: *Global Employment Trends*, 2009.

51. As was the case in previous crises, this could generate substantial downward pressure on informal-economy wages, which before the current crisis were already declining and are substantially lower than for regular workers.[27] This is also likely to lead to a reduction in the number of days worked.[28] This combination of factors will reduce incomes at the household level and erode purchasing power, leading to an increase in the proportion of working poor in most developing economies (Figure 3, Panel B). Based upon a threshold of $2 per day, over 2008 and 2009 the incidence of working poverty is expected to rise across all developing regions. This will add over 75 million people to the working poor, with most of the increase occurring in South Asia and Sub-Saharan Africa.

52. Rising working poverty will compound the effects that the increase in food prices has had on the poor in developing countries (Box 3). And while prices have now fallen, given their recent volatility there is a risk that then when demand for food commodities recovers, the challenges associated with poverty will intensify.

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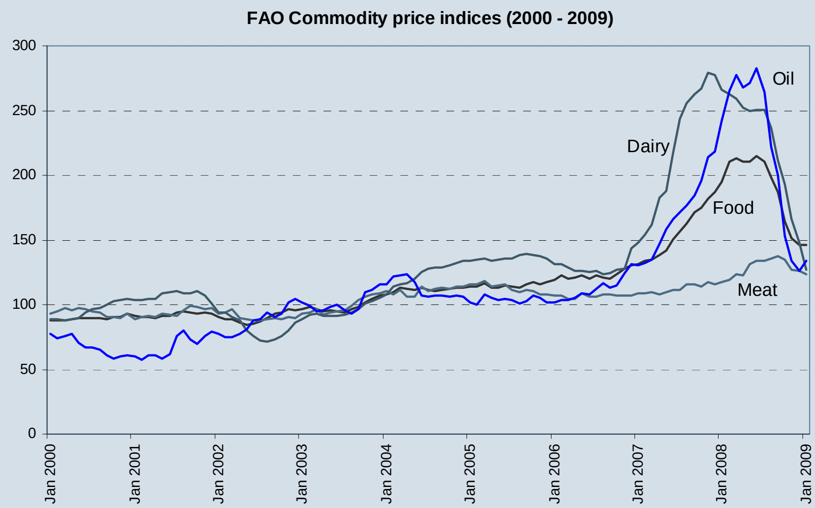
[26] *Ibid.* Scenario 3: Projection on the basis of a simultaneous increase in the unemployment rate in the developed economies and the European Union equal to the largest increase since 1991 and half of the largest increase since 1991 in economies in other regions; IMF revised estimates for economic growth, November 2008.
[27] ILO: *World of Work Report. Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.
[28] G. Betcherman; R. Inslam (eds.): *Op.cit.*

Box 3. Unstable food prices and impact on the poor

The rise in food prices between 2005 and 2008 is estimated to have increased the share of the population of East Asia, the Middle East, and South Asia living in extreme poverty by more than 1 percentage point. The impact on Africa was relatively lower because food prices increased somewhat less than in other regions. As the poor in developing countries spend 50 percent or more on food, the increase in food prices had a disproportionate impact on them. Since July 2008, prices of all commodities, including food items, have fallen sharply mainly reflecting declining world demand. However, food prices remain well above the levels reached in the 1990s.[29]



Source: Food and Agriculture Organization of the United Nations (FAO), February 2009.

… *entailing a risk of prolonged labour market recession*

53. Previous crises show that it take much longer to reach pre-crisis employment levels than to restore economic growth – with the impact from banking-related crises often being deeper and more prolonged (Box 4).

Box. 4 Aftermath of banking crises and employment recovery after recessions

Banking crises typically have long-lasting effects on employment.[30] Earlier crises caused, on average, a drop in GDP for approximately two years and increases in unemployment for a much longer period – 4 to 5 years. Furthermore, as growth of government revenues weakens significantly in the year of a crisis and declines in the following years, the real value of government debt tends to surge, rising an average of 86 per cent. Thus, the fiscal consequences of banking crises reach beyond the immediate sector-specific bailout costs.

The figure below shows the duration of the last two recessions in the United States (1991 and 2001).

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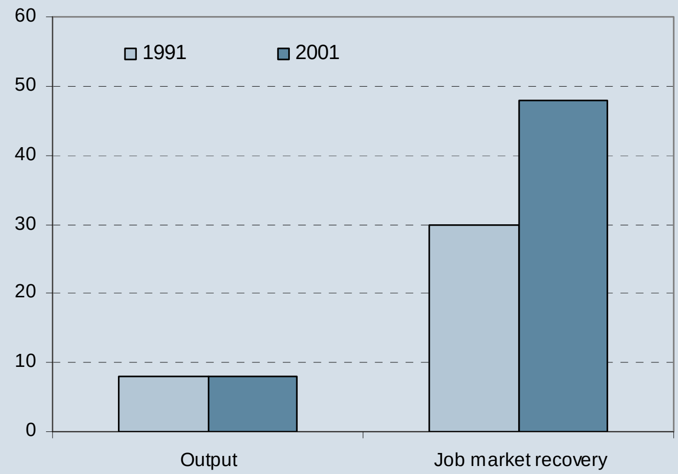
[29] *Ibid.*

[30] See C.M. Reinhart; K.S. Rogoff: *Banking Crises: An Equal Opportunity Menace*, National Bureau of Economic Research (NBER), Working Paper No. 14587, 2008a; and C.M. Reinhart; K.S Rogoff: *The Aftermath of Financial Crises*, paper prepared for presentation at the American Economic Association, 2008b.

Both recessions lasted eight months (according to the National Bureau of Economic Research), but the job market recovery took 30 months in the case of the 1991 recession and 48 months in the 2001 recession. In other words, not only does it take much longer for the job market to recover in response to a recession, but the time it takes for such recovery to materialize seems to have increased in recent years.

Duration of output recovery and job market recovery after the 1991 and 2001 US recessions (in months)



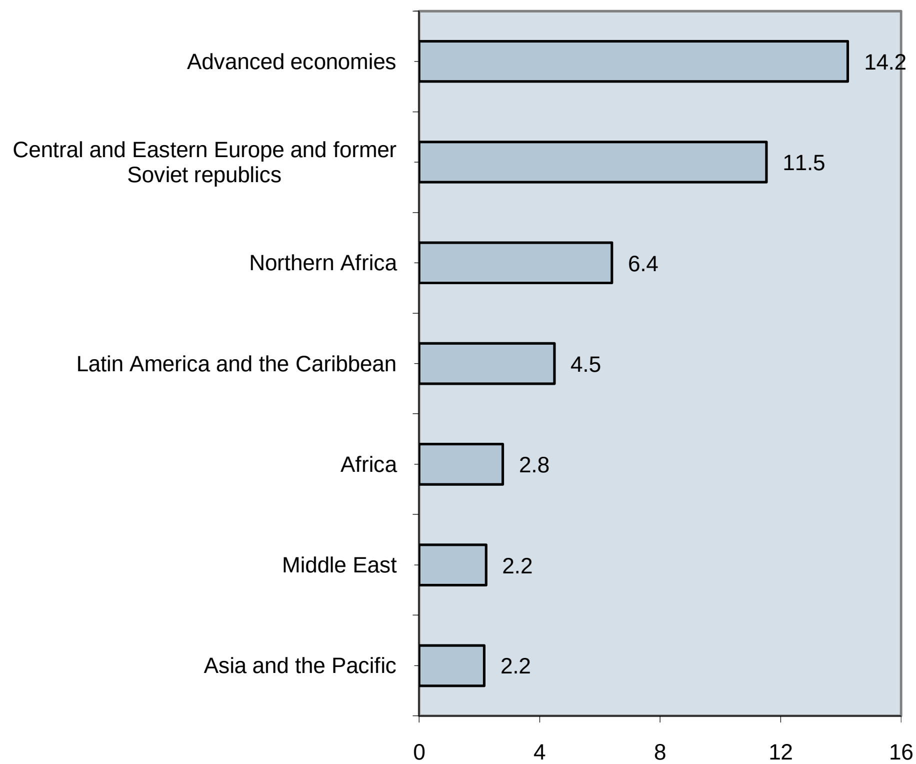
Source: J. Irons, *How long would a job-market recovery take?*, Economic Policy Institute, 7 January 2009.

Depending on social protection coverage, the labour market recession will lead to significant social hardship...

54. Social protection, if well designed, plays a crucial role in alleviating social hardship in the face of the crisis. Yet, the array of benefits and support measures available to individuals varies significantly across countries and regions. Social spending as a share of GDP ranges from as high as 14 per cent in advanced economies to as low as 2 to 3 per cent in Asia, the Middle East and Sub-Saharan Africa (Figure 4). The reality is that in many emerging and developing countries, the majority of workers do not contribute to basic social security coverage, including unemployment benefits.[31] This is due mainly to the fact that most employment is in the informal economy.

[31] It is important to note that in many countries – emerging, developing and developed – unemployed workers often have access to other benefits and support (e.g. social assistance, training, etc.).

Figure 4. **Social expenditures as a per cent of GDP, most recent year available***



* Social expenditures (consolidated central government) are defined as transfers to protect the entire population against certain social risks such as medical services, unemployment compensation, social security pensions, and social assistance benefits. Social security benefits include sickness and invalidity benefits, maternity allowances, children's or family allowances, unemployment benefits, retirement and survivors' pensions, and death benefits. Subsidies, grants, and other social benefits include all unrequited, non repayable transfers on current account to private and public enterprises; grants to foreign governments, international organizations, and other government units; and social security, social assistance benefits, and employer social benefits in cash and in kind.

Source: IMF: Government Financial Statistics, 2007.

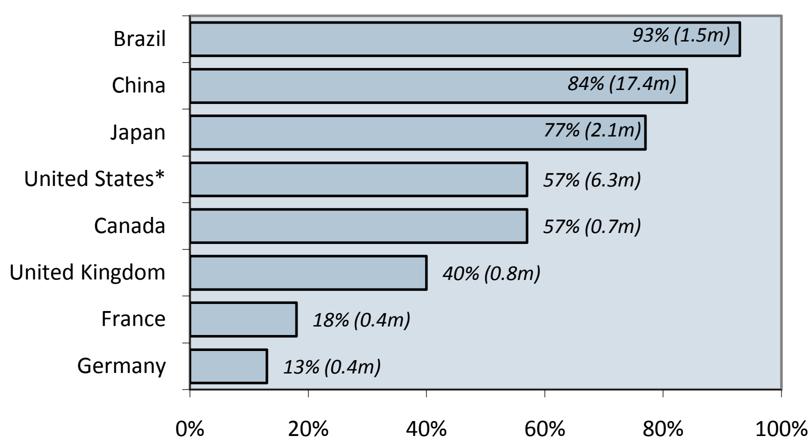
…as millions of workers are left without adequate support…

55. Even where unemployment benefit systems exist in emerging and developing economies, they are often restricted to urban areas. For example, in China, close to 5 million unemployed urban workers (57 per cent) were without unemployment insurance in 2005. Given that over 60 per cent of total employment in China is in rural areas, the share of unemployed workers unable to access unemployment benefits is probably closer to 84 per cent (Figure 5).

56. In many developed countries, job losers are often not eligible for unemployment benefits. In half of the OECD member countries, 50 per cent or more of the unemployed do not receive unemployment benefits (though non-recipients may be entitled to social

assistance benefits).[32] Even in countries like France and the United Kingdom, where coverage is greater, many workers do not receive unemployment benefits (Figure 5).

Figure 5. **Share (and number) of unemployed workers NOT receiving unemployment benefits**



* For the United States, if benefits under the extended unemployment compensation programme authorised by Congress in the summer of 2008 are also included, the rate declines to 42 per cent.

Source: IILS estimates based on national statistics. For Brazil, recipiency rate is taken from Vroman and Brusentsev: *Unemployment Compensation Throughout the World: A Comparative Analysis*, 2005, and applied to the level of unemployment from the December 2008 Labour Force Survey.

57. In Canada, Japan, and the United States, where regulations governing access to such benefits are often much stricter, the share of unemployed workers not receiving benefits can be well over half. As of January 2009, more than 6 million jobless Americans were *not* receiving unemployment insurance. In Japan, about 77 per cent of unemployed persons do not receive unemployment benefits.

58. The absence of unemployment benefit support is made worse by the fact that for many individuals social protection is conditional on being employed. The immediate fall in income resulting from unemployment is thus worsened by the loss in non-cash benefits such as employer-sponsored health. The loss of these benefits can be a particularly severe blow to middle- and low-income households.

…and retirement savings are eroded

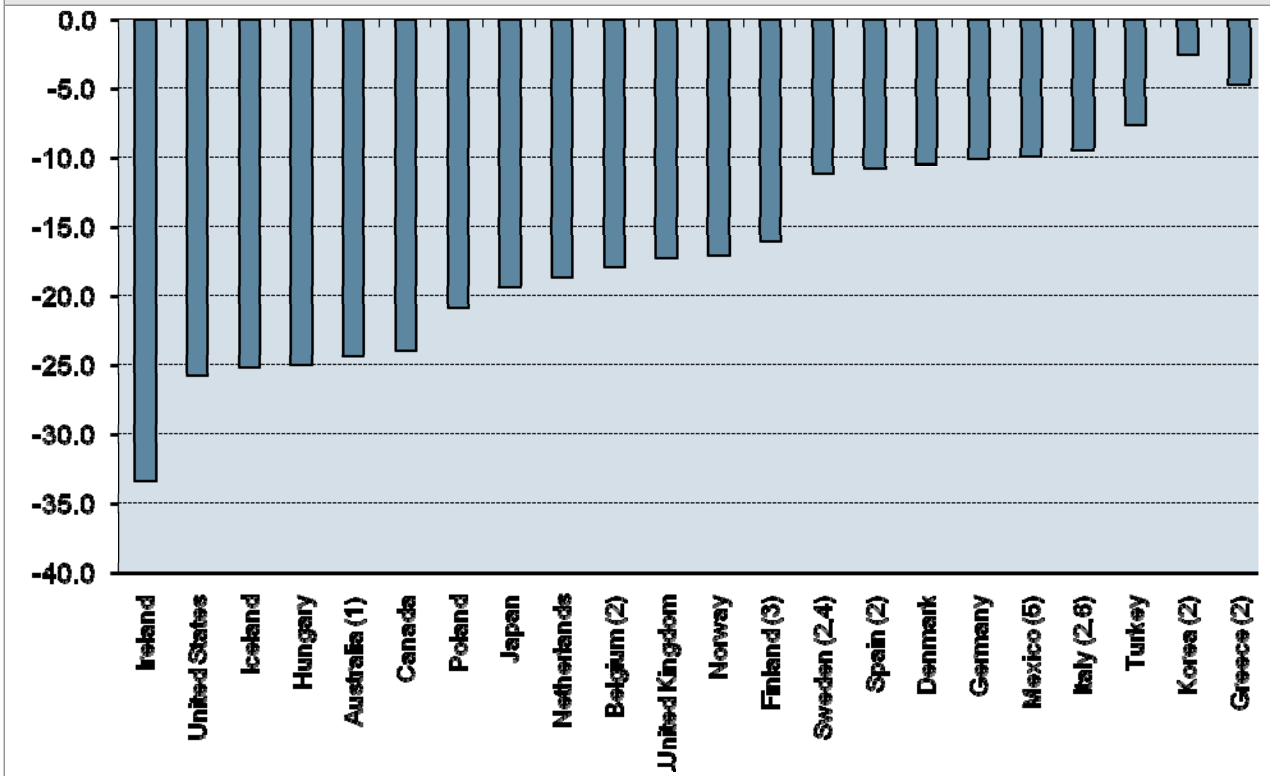
59. An immediate consequence of the collapse of stock markets in 2008 has been the dramatic decline in individual wealth held in pensions.[33] According to the OECD, between January and October of 2008, private pensions registered losses of nearly 20 per

[32] The generosity and replacement rates of unemployment benefits – an important consideration – vary significantly from country to country, and should not be taken as an indication as to the amount of money spent on non-work assistance. OECD: *Employment Outlook*, 2008; C. Stone; R. Greenstein; M. Coven: *Addressing Longstanding Gaps In Unemployment Insurance Coverage*, Center on Budget and Policy Priority, 2007; and OECD Database on Benefits and Wages.

[33] Losses in advanced economies approached 40 per cent in 2008. The MSCI Emerging Market Index (25 emerging country indices) lost more than half its value (54.5 per cent) over the same period – the worst annual performance since the measure was created two decades ago.

cent – representing a value of $4.5 trillion (Figure 6). This has prompted concerns about the adequacy of retirement savings for many individuals.

Figure 6. **Pension fund returns (real), for selected countries, January-October 2008 (percentages)**



(1) Official data up to June 2008 then complemented by OECD estimate up to October.
(2) 2008 data refer to 30 September 2008.
(3) Data refer to statutory earnings-related pension plans
(4) Data refer to occupational pension plans only.
(5) Data refer to the mandatory and voluntary pension systems.
(6) Data refer to new pension funds (contractual and open) instituted after 1993 legislation.

Source: OECD.

60. In World Bank client countries with funded pension systems, losses in pension funds range from 8 per cent to 50 per cent.[34] In Chile, for example, the private pension funds that cover 8.3 million workers lost a total of $25 billion in 2008. Traditional pension systems provided by governments on a pay-as-you-go basis will also be affected by the current downturn, but much less than private pension funds. Interestingly, in view of the pension crisis, the World Bank has shifted its stance on this matter and is now advocating greater focus on government-backed pay-as-you-go systems.[35]

[34] World Bank: *The Financial Crisis and Mandatory Pension Systems in Developing Countries*, 2009.
[35] *Ibid*.

These developments come on the heels of an expansionary period where the gains of growth were unevenly distributed

61. The global economic crisis comes after a sustained period of growth, whose benefits were unevenly shared.[36] During the two decades that preceded the crisis, the incomes of richer groups grew faster than those of middle- and low-income groups.[37] As mentioned in Box 1, growing income inequalities within countries contributed to an increase in the demand for credit, which, in conjunction with poor financial regulation, lies at the heart of the current crisis.

In sum, the risks of prolonged labour market and enduring social crises need to be averted

62. By definition, any financial crisis has serious consequences on the entire real economy, which depends so vitally on financial markets in order to grow and create jobs. But the current financial crisis is deeper than recent ones. It has its origins in developed countries which had been the engine of global demand and trade growth. In addition, given the strong international inter-linkages, it affects most countries. And, against the backdrop of the pre-crisis expansionary period, in which gains were unevenly shared, the economic and social costs of the crisis are noticeably widespread. Perceptions of unfairness are mounting, increasing the risk of social instability.

63. The challenge is to avoid a major labour market and social crisis. Already, job losses have mounted and new entrants like youth have had difficulty finding employment. However, the rise in unemployment has been contained to some extent as firms have attempted to limit the extent of layoffs via recourse to shorter hours and partial unemployment. This could change with a prolonged recession – in such an event, significant increases in unemployment would be unavoidable and, in developing countries, a long-lasting shift to informality and higher working-poverty would occur.

64. A prolonged recession would have deeper effects than just higher unemployment and increased informality and working-poverty. With so many people around the world lacking social protection, social hardship resulting from poor job prospects would intensify. Some developing countries will also need to integrate growing numbers of return migrant workers. And within countries the movement of workers from urban centres where jobs disappear, back to rural areas poses acute challenges as well. Social protection itself is being affected by the crisis, at the time when it is most needed, especially in countries that relied excessively on private pension funds or employer-provided health care.

[36] ILO: *World of Work Report. Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.
[37] *Ibid.* and ILO: *Global Wage Report*, Geneva, 2008.

II. International and country responses to the crisis

65. Given the grim economic outlook, and risk of widespread labour market and social consequences, countries around the world have adopted unprecedented measures to address the global economic slowdown. This section provides a brief overview of the outcomes of efforts to coordinate the measures among countries. It also describes rescue efforts undertaken by 40 countries (including the G20).[38] This includes an overview of the labour market initiatives that have been put in place, and the role of social dialogue and tripartite institutions in shaping the discourse to date.

International efforts to coordinate responses to the crisis have been stepped up

66. The global financial market has been unstable since as early as 2007. But 2008, marked by bankruptcies and bailouts of financial institutions (notably AIG, Bears Stearns and Lehman Brothers) placed the financial system in a state of constant turmoil and volatility. Credit markets froze and stock indices tumbled throughout 2008. The first round responses were largely uncoordinated, but the case for more internationally coordinated action has become increasingly clear – as witnessed by several efforts. These include:

- the G20 commitment at the meeting in Washington in November 2008, which prescribes action to be taken in key determinants of decent work and agrees on the importance of coordinating macro-economic policies and reducing global imbalances;
- an Economic Recovery Plan approved by the European Council in 2008 (200 billion euros), which aims to boost demand through joint fiscal stimulus action as well as temporary support for the unemployed through cash transfers and extension of unemployment benefits. It also calls for lower taxes and social contributions, and measures targeting small enterprises.[39]

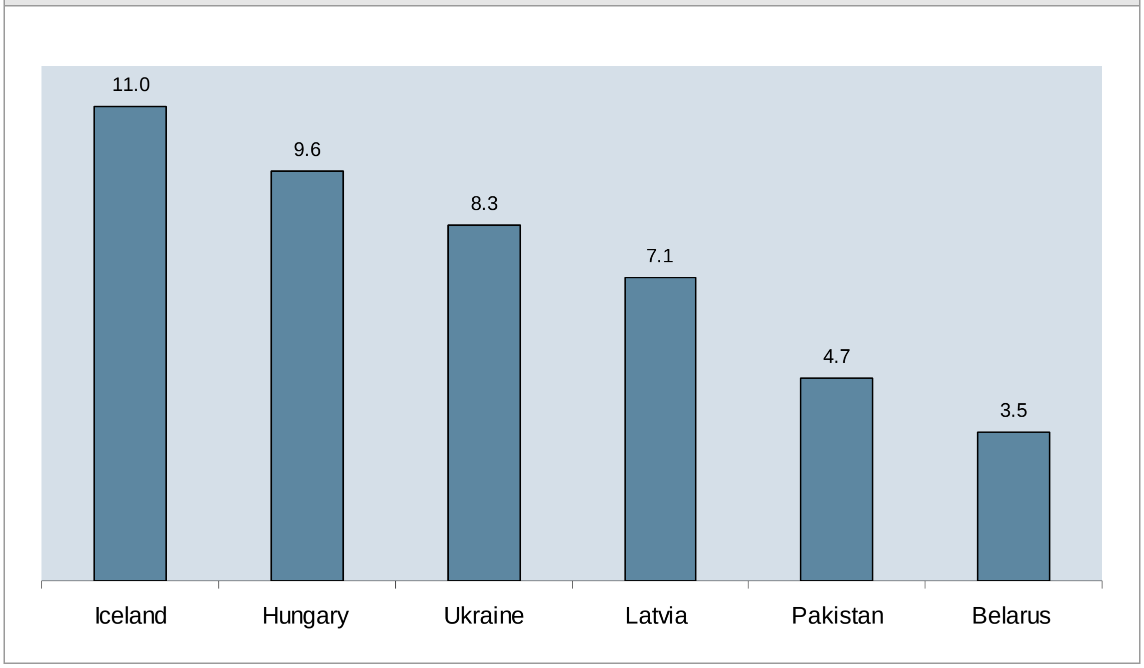
67. Addressing the social dimensions of the crisis is at the core of ILO's mandate. The Social Justice Declaration stresses that "As trade and financial policy both affect employment, it is the ILO's role to evaluate those employment effects to achieve its aim of placing employment at the heart of economic policies".

68. The IMF has provided financial assistance to countries affected by rapidly declining capital inflows, and balance of payments deficits. The policy response by most emerging economies facing such situations has generally involved pro-cyclical fiscal and monetary tightening designed to restore market confidence, combined with IMF interventions to

[38] For a detailed presentation of the measures, see S. Khatiwada: *Stimulus packages to counter the global slowdown*, IILS, ILO, forthcoming 2009.
[39] On 11 and 12 December 2008, the European Council approved a European Economic Recovery Plan, equivalent to about 1,5 per cent of the GDP of the European Union. The plan provides a common framework for the efforts made by Member States and by the institutions of the European Union.

bail out international creditors and investors.[40] Therefore, as part of the crisis resolution tools available for countries, the IMF has offered its fast-track emergency lending facilities. So far, the governments of Belarus, Hungary, Iceland, Latvia, Pakistan and Ukraine have resorted to IMF loans to restore their financial and economic systems (Figure 7). Latvia has a stand-by arrangement whereby IMF credits can be provided to finance a temporary balance of payments deficit. The IMF also has about $200 billion for immediate lending and can draw an additional $50 billion if needed.[41]

Figure 7. **IMF assistance as percentage of GDP**



Source: IMF.

Governments have provided prompt, massive support to rescue the financial system…

69. Government efforts to strengthen bank balance sheets were initially undertaken on a case-by-case basis. For example, the United States and European governments injected capital into individual banks or induced mergers in hopes of reviving the credit market by encouraging banks to lend to one another. But market confidence continued to decline and credit markets remained frozen, highlighting the need for system-wide intervention.

70. The system-wide interventions subsequently put in place by the United States and European governments have involved ensuring bank funding through explicit government guarantees on retail deposits and other bank liabilities, and reducing bank leverage through government purchases of distressed assets or capital injections. Almost all the major economies have increased guarantees of private deposits, put in place inter-bank loan guarantees, banned or restricted short-selling and injected capital into troubled banks by buying equity stakes (Table 2).

[40] Y. Akyüz: *From liberalization to investment and jobs: Lost in translation*, Policy Integration and Statistics Department, Working Paper No. 74, ILO, Geneva, 2006.
[41] As IMF Managing Director Dominique Strauss-Khan recently pointed out, the IMF may need another $150 billion to help counter the hit to emerging markets and poor countries. Japan has pledged $100 billion while other nations have yet to commit to help.

71. Australia, Canada, Germany, Norway, Spain, Switzerland and the United Kingdom have opted to buy (or insure) toxic assets, while the United States abandoned this plan in favour of direct capital injections. However, under the new administration, the United States is considering getting troubled assets off banks' balance sheets by using at least $500 billion (possibly up to $1 trillion) in private and government money. The three main elements of the new programmes proposed by the United States Treasury Secretary are: injecting government capital into the biggest financial institutions; establishing public-private partnership to buy banks' troubled assets; and starting a credit facility with the Federal Reserve with as much as $1 trillion to promote lending to consumers and businesses.

Table 2. **Crisis resolution instruments for select countries**[1]

	Increased guarantee of private deposits	Guarantees for bank loans or debt	Fund to purchase commercial papers	Purchase mortgage bonds	Ban or restrict short-selling[2]	Capital Injections	Option to purchase toxic assets	Induced Mergers & Acquisitions	IMF's emergency lending
Australia	X	X		X	X		X		
Austria	X	X			X	X			
Belgium	€ 100,000	X			X	X			
Brazil								X	
Canada		X		X	X		X		
China						X		X	
Denmark	X	X		X	X				
Finland	€ 50,000	X			X				
France	€ 70,000	X			X	X			
Germany	X	X			X	X	X		
Greece	€ 100,000	X			X	X			
Hungary	€ 50,000	X				X			$15.7 billion
Iceland	X					X			$2.1 billion
India						X			
Indonesia	2 billion rupiahs								
Ireland	€ 100,000	X				X			
Italy	€ 100,000				X	X			
Japan		X			X				
Korea	X	X				X			
Mexico		X							
Netherlands	€ 100,000	X			X	X			
New Zealand	X	X							
Norway	X	X					X		
Poland	€ 50,000								
Portugal	€ 100,000	X				X			
Russian Federation	X	X			X	X			
Spain	€ 100,000	X		X	X		X		
Sweden	€ 50,000	X		X		X			
Switzerland	X		X			X	X		
Turkey									X
United Kingdom	£50,000	X		X	X	X		X	
United States	$250,000	X	X	X	X	X	X	X	

(1) Most crisis resolution instruments were put in place in October-November, 2008; only the countries that instituted at least one measure are included. An "X" denotes some action taken by a country in the corresponding area.
(2) Ban on short-selling has been lifted for some asset classes in Switzerland and the UK.
Source: IILS based on Bloomberg, Bank for International Settlements and OECD.

…which has been supported by monetary easing and other actions of central banks

72. In addition, central banks around the world have taken action to address the challenges in the global financial market by means of providing liquidity and easing monetary conditions.[42] For example, the United States Federal Reserve Bank and other major central banks, including the European Central Bank, the Bank of England, and the Bank

[42] Quantitative easing involves increasing the base money stock by purchasing government securities and qualitative easing involves purchasing private securities, including possibly illiquid private securities and/or private securities subject to substantial default risk.

of Japan increased assets substantially in order to provide direct lending to banks and dealers through existing and new lending facilities.

73. In addition, aggressive monetary easing has been adopted in light of the rapidly deteriorating economic outlook, including a series of internationally-coordinated interest rate cuts (Table 3). This shift in focus of monetary policy from inflation targeting to supporting economic activity has been supported by a rapid decline in inflation, with some countries now facing deflation pressures. For example, the United States Federal Reserve cut its federal funds rate to a historically low level of between 0 and 0.25 per cent. Even among emerging economies, inflation fears have largely subsided with the rapid decline of commodity prices. However, despite these efforts, global economic activity has continued to decline and with rates at near-zero levels in some cases, further recourse to monetary policy is limited. Governments have thus turned their attention to fiscal rescue packages.

Table 3. **Monetary policy - interest rate changes**

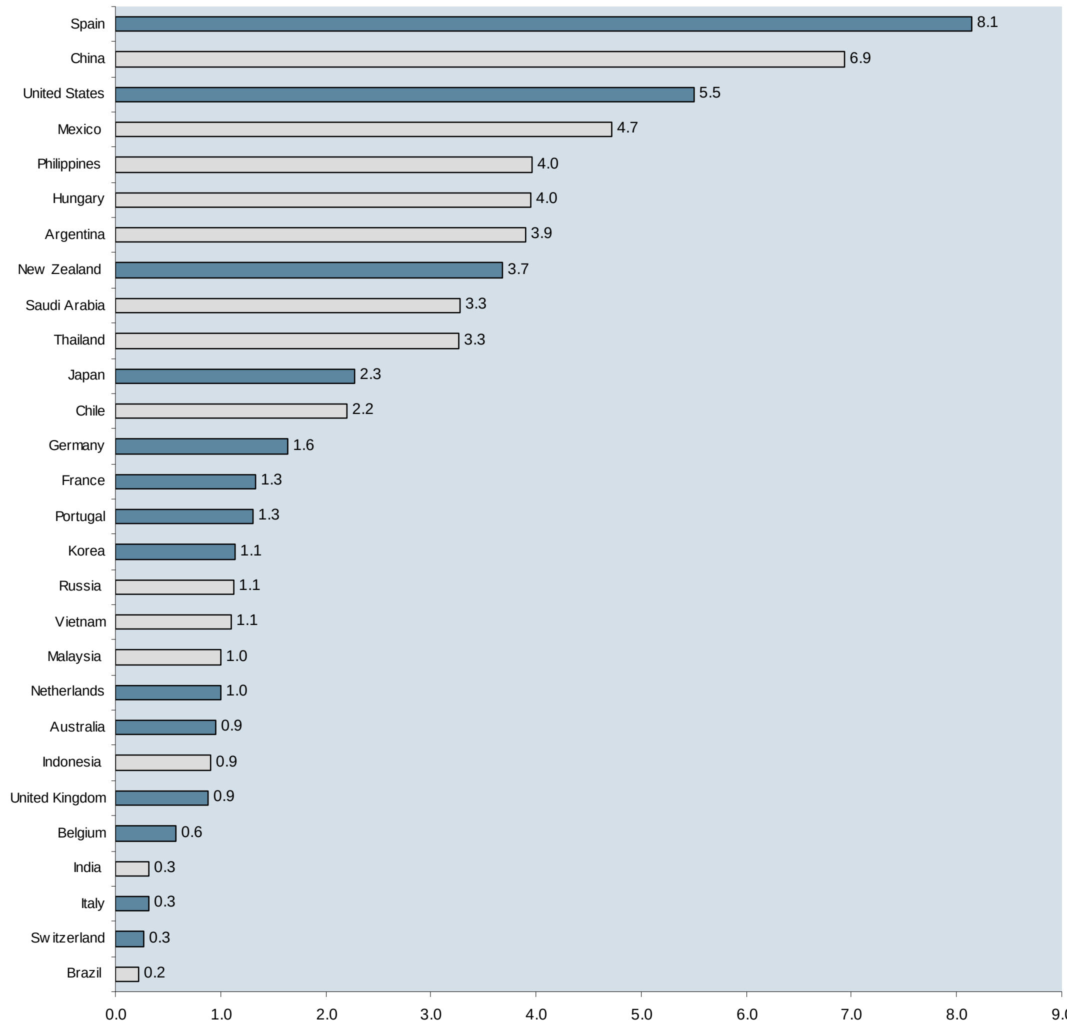
Australia	Cut to 3.25 per cent, February 2009	**Malaysia**	Cut by 0.75 per cent to 2.5 per cent, January 2009
Austria	Cut (ECB)[1]	**Mexico**	Cut by 1 per cent to 6.75 per cent, January 2009
Belgium	Cut (ECB)	**Netherlands**	Cut (ECB)
Brazil	Cut by 1 per cent to 12.75 per cent, January 2009	**New Zealand**	Cut by 1.5 per cent, December 2008
Canada	Cut by 2.25 per cent over 2008; cut by 0.5 per cent to 1 per cent, January 2009	**Nigeria**	Cut by 0.55 per cent to 9.7 per cent, September 2008
Chile	Cut the overnight lending rate by 1 per cent to 7.5 per cent, January 2009; cut by another 0.25 per cent to 7.25 per cent, January 2009	**Norway**	Cut
China	Cut one year lending rate by 1.89 per cent to 5.58 per cent, December 2008; cut by another 0.27 per cent to 5.31 per cent, December 2008	**Philippines**	Cut by 0.5 per cent to 5 per cent, January 2009
Denmark	Cut by 0.75 per cent to 4.25 per cent, December 2008	**Poland**	Cut
Finland	Cut (ECB)	**Portugal**	Cut (ECB)
France	Cut (ECB)		
Germany	Cut (ECB)	**Saudi Arabia**	Cut main repo rate by 0.5 per cent to 2.5 per cent, December 2008; cut by another 0.5 per cent to 2 per cent, January 2009
Greece	Cut (ECB)	**South Africa**	Cut main repo rate by 0.5 per cent to 11.5 per cent, December 2008
Hungary	Increase by 3 per cent, October 2008 (emergency measure); cut by 0.5 per cent to 10.5 per cent, December 2008; cut by another 0.5 per cent to 10 per cent, December 2008	**Spain**	Cut (ECB)
Iceland	Increase (emergency measure)	**Sweden**	Cut by 1.75 per cent, December 2008
India	Cut repo rate by 1.5 per cent to 7.5 per cent, October 2008; cut by 1 per cent to 6.5 per cent, December 2008; cut by another 1 per cent to 5.5 per cent, January 2009	**Switzerland**	Cut to 0.5 per cent, December 2008
Indonesia	Cut by 0.25 per cent to 9.25 per cent, December 2008; cut by 1.5 per cent to 8.75 per cent, January 2009; cut by 0.5 per cent to 8.25 per cent, February 2009	**Thailand**	Cut to 2 per cent, January 2009
Ireland	Cut (ECB)	**Turkey**	Cut to 13 per cent, January 2009
Italy	Cut (ECB)	**United Kingdom**	Cut by 1 per cent to 2 per cent, December 2008; cut by 0.5 per cent to 1.5 per cent, January 2009; cut by another 0.5 per cent to 1 per cent, February 2009
Japan	Cut by 0.2 per cent to 0.3 per cent, October 2008; cut by another 0.2 per cent to 0.1 per cent, December 2008	**United States**	Cut by 3.25 per cent from January to October 2008; cut to a range of 0.25 to 0 per cent, December 2008
Republic of Korea	Cut by 1 per cent to 3 per cent, December 2008; cut by another 1 per cent to 2 per cent, February 2009	**Vietnam**	Cut by 1.5 per cent to 7 per cent, January 2009

(1) The European Central Bank (ECB) rate stands at 2 per cent as of January 2009.
Source: IILS, based on national sources.

Fiscal stimulus packages have been announced, though with a delay vis-à-vis financial rescue measures…

74. As the G20 Summit in Washington underscored, there is a growing consensus that aggressive fiscal measures – cutting taxes and boosting spending – are required to stimulate domestic demand and avert the worst economic slump since the Great Depression. As a result, countries have announced fiscal rescue packages of varying sizes, with Spain announcing the biggest package as a percentage of GDP, followed by China and the United States (Figure 8).

Figure 8. **Fiscal package as a percentage of GDP (as of February 2009)***



* 2008 GDP from IMF World Economic Outlook. Developed economies are indicated in dark; developing and emerging economies, in gray. Time frame of spending is not clear for most countries and in some cases, package was announced but not the details. For China, Germany and the United Kingdom, the time frame is 2 years, hence the total package was divided by 2.

Source: IILS, based on national sources.

… a degree of uncertainty regarding the precise size and timing of the package…

75. However, there are uncertainties regarding the exact size and timing of the stimulus packages. First, the breakdown of rescue efforts in terms of old spending (already in the pipeline) and new spending is uncertain. Second, the time-horizon in which the stimulus package will be administered is also unclear. For some countries like China, Germany and the United Kingdom, the time frame is two years (2009-10), but for most countries, the time frame of new spending measures has not been decided as yet.[43] Third, most countries have announced fiscal rescue packages different from their financial rescue packages, but there is a tendency to count in financial help to different sectors (like loan guarantees) as part of the package. For the countries examined here, an attempt has been made to disentangle fiscal efforts from financial efforts. And fourth, some countries have

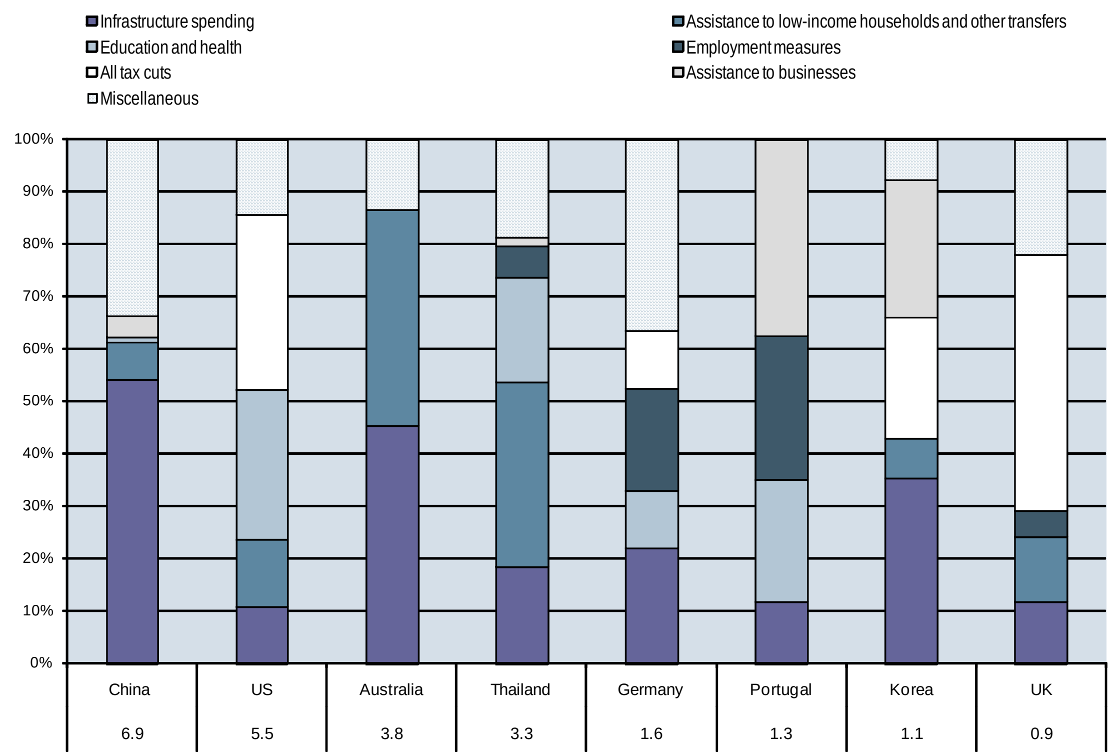
[43] The total rescue package for the China, Germany and the United Kingdom is divided by two before calculating the package as a percentage of GDP.

announced stimulus spending embedded in their annual budgets, which makes it difficult to identify the size of new spending.

... and significant variation in the composition of spending efforts…

76. Across a range of 8 countries with detailed available data, there is significant variation in terms of the emphasis placed on different components of the stimulus package (Figure 9). All, however, have dedicated resources to infrastructure spending, though the share ranges from over half (54 per cent) in China to as low as 11 per cent in the United States. On the other hand, the degree of employment measures and support to low-income households is generally limited. For example, only half the countries have implemented employment measures (notably Germany and Portugal) and only Australia and Thailand dedicate significant resources to low-income households.

Figure 9. **Composition of spending as a percentage of total for selected countries**



* Countries are organized by rescue package as a percentage of GDP.
Source: IILS, based on Bloomberg, Asian Development Bank, and New York Times.

77. A broader analysis of the 40 countries with available data confirms that the composition of rescue packages varies considerably, but almost all the rescue efforts can be divided into three main areas: increase spending on public goods and services, fiscal stimulus aimed at consumers (*e.g.* personal income tax cuts, cash transfers), and fiscal stimulus aimed at firms (*e.g.* corporate tax cuts).

78. In terms of *spending on public goods and services*:

- At least half the countries have announced spending increases in infrastructure and on education and health. The former focus on building and repair of roads, bridges, railway lines, and rural infrastructure projects with attention given to projects in the pipeline (*e.g.* China, Italy, and the Netherlands). Others like China, Japan, Portugal, and the United States have announced investment in energy efficient projects as part of infrastructure investments. China and Thailand have also announced measures to increase home availability (through public housing projects) for poor households.

- In terms of education and health, China and Saudi Arabia have announced significant increases in education and health spending with some school and hospital constructions as part of rural development programmes for several countries.

79. In terms of *fiscal stimulus aimed at consumers*:

- Germany, New Zealand, Russian Federation, Spain, the United Kingdom, and the United States are some of the many countries that opted for tax cuts aimed at stimulating consumer spending (these tax cuts fall into two categories: income tax cuts and sales tax cuts such as VAT reductions). Others have adopted tax cuts to boost sales in certain sectors, such as automobiles in Brazil, Germany and Turkey.
- Australia, Italy, Mexico and the United States have put in place measures to help home buyers. In some cases, this includes incentives for consumers to purchase energy efficient homes and "greening" existing homes by providing subsidies and tax exemptions.
- Australia, China, France, Indonesia, Italy, Japan, Mexico, Philippines, Spain, and the United States have announced increases in social transfers aimed at poor and low-income households. Social transfers include direct cash transfers, conditional cash transfers, and social welfare programmes.

80. In terms of *fiscal stimulus aimed at firms*:

- Several stimulus packages have placed emphasis on the viability of large firms, especially in the financial and automotive sectors.
- In some cases, measures have been explicitly targeted at SMEs (e.g. Japan, the Republic of Korea, and Mexico). In addition, public investments in infrastructure, construction and housing will also provide new market opportunities for SMEs. Other measures to firms have been specifically targeted to mitigate the impact on employment.

... and varying degrees of direct support for employment and social protection…

81. Some countries have announced explicit measures to help workers and employers as part of their fiscal rescue efforts (see some country examples in Table 4):

- Japan and the United States have put in place extension of unemployment benefits. France and Switzerland have also put in place more generous systems of unemployment benefits for temporarily laid-off workers. Meanwhile, Canada, China, and Turkey are in the process of extending unemployment benefits. Other countries like Korea, Philippines, and Thailand have announced country-specific measures to assist vulnerable workers.
- Some countries are making greater use of in-work benefits in conjunction with reduced working hours to curtail layoffs. For example, in Germany, the government extended the possibility for workers who continue to be employed – but at reduced working hours – to receive income supplements, and companies are reimbursed 100

per cent of their social security contributions on behalf of employees when the down time (i.e. reduced working hours) is used for training.

- To encourage hiring, some countries have announced subsidies and exemptions. For example, the United Kingdom has announced subsidies for employers (up to £2,500) who hire workers who have been unemployed for more than six months, and Japan has announced subsidies for employers who hire temporary workers as regular employees. Other countries that have announced some sort of hiring incentives include Australia, Chile, China, France, Germany, Korea, the Netherlands, and the United States.
- Australia, Canada, Chile, China, France, Germany, Indonesia, Japan, Korea, Portugal, Thailand, the United Kingdom and the United States have announced training programmes for laid-off workers as part of their labour market initiatives. Training programmes include, among others, vocational workshops for laid-off migrant workers, and expanded opportunities for apprentices in trades.
- It is also likely that the new infrastructure projects, discussed briefly above, and increased funding for local governments will result in more public sector jobs. As of February 2009, some 20 countries of the 40 have made such announcements.

82. A few countries have announced *explicit goals for job creation*. These include Chile (100,000), France (80,000 to 110,000), Hungary (20,000), Indonesia (2.6 million), Spain (300,000) and the United States (3.5 million). In France, Spain and the United States, job goals include the creation of green jobs. However, the goals for job creation do not include plans to save existing jobs.

Table 4. **Examples of labour market initiatives in response to the crisis**[1]				
	I. Extension of unemployment benefits	**II. Activation measures**		**III. Increase in public sector jobs**[3]
		A. Hiring incentives for employers[2]	**B. Other activation measures (job-search help, training, measures targeted at disadvantaged group, etc.)**	
Argentina				X
Australia		Funds to employers for staff development and training programs	Increase in productivity training places from 57,000 to 113,000	X
Brazil	Increase in minimum wage by 12 per cent as of February 2009, which will affect 45 million workers; expansion of UE benefits from 3 to 5 months to 5 to 7 months			
Canada	X (ongoing discussions but not approved)		$1.5 billion in training fund for laid-off workers	
Chile		X		X
China	X (ongoing discussions at the local and regional level; recommended by the central government)	Reduction in medical and accident insurance premiums; flexible working hours and pay for service sector firms	Nationwide vocational training program for migrant workers returning home after losing jobs	A temporary moratorium on firing in state owned enterprises
France		Employers with less than 10 employees will not pay social taxes for each new employee they hire in 2009.	X	X
Germany	X	Reduction in health insurance contribution	X	
India				X
Indonesia			Job training; voluntary transmigration programs for laid off workers to areas less affected by the crisis	X
Italy				X
Japan	X	Increased subsidies for SME employers; subsidies for employers who hire temporary workers as regular employees	Support for non-regular workers in job-placement	Financial support to local governments that hire job-seekers
Korea	Support vulnerable workers (outside the boundaries of a social safety net) who are put on unpaid temporarily leave	Tax exemption and extension on tax submission periods for employers that maintain their workforce	X	X
Malaysia			Training for retrenched workers; re-training unemployed graduates over the next 2 to 3 years	
Mexico			Increase in seasonal employment programme	
Netherlands		Subsidies for company payrolls		X
Philippines	Increase in conditional cash transfers			
Portugal			€580 million in employment programmes	X
Saudi Arabia				X
Spain				X
Thailand	Cost of living alleviation projects and sustenance allowance		Capacity building for the unemployed	X
Turkey	X (proposed but not approved)			
United Kingdom		Subsidies for employers (up to £2,500) who hire workers that have been unemployed for more than 6 months	X	X
United States	Extension of unemployment benefits; health insurance for those who lost their job; increase in food stamps; increase in social security benefits	X	X	X
Vietnam	New unemployment insurance started in January 2009			X

1. This table includes only the explicitly announced measures. An "X" denotes some action taken by a country.

2. Corporate tax cuts are not counted as an incentive for employers to hire, nor are sectoral subsidies.
3. All the countries with increased spending in infrastructure projects are counted, as they increase public sector employment.
Source: IILS, based on national sources.

…with some efforts to engage social partners

83. In the early stages of the crisis, social partners in many countries had limited involvement in the design and implementation of government anti-crisis measures.[44] More recently, in some cases, social dialogue has been at the heart of governments' plan to address the economic slowdown. These include:

- In Ireland, an agreement was signed between the government and the social partners, following a discussion of the government's recommendations for sustainable economic renewal. The agreement covers issues of pay growth, employment rights of temporary workers, and voluntary arbitration, among others.
- In Pakistan, the tripartite Labour Conference was addressed by the Prime Minister, who announced a new era of consultations with social partners, and modernization of the country's labour law in cooperation with the ILO and the WTO.

84. In some cases, agreements arising from social dialogue initiatives have been embodied into law, such as the decree on partial unemployment benefits in France. Other countries such as Germany have passed a second economic stimulus package following extended consultations with national employers and workers' organizations. In the Russian Federation, the national tripartite commission dealt with the social impact of the crisis several times since October 2008. In some countries, these bipartite or tripartite consultations and negotiations went beyond the scope of narrowly defined labour issues, but also dealt with state budgets and larger economic and policy matters.

In sum, action has been swift, but relatively misaligned

85. There has been considerable emphasis on rescuing the financial sector. As Figure 10 shows, the amount spent on financial rescue efforts far surpasses fiscal rescue efforts for all countries except the United States.[45] Indeed, protecting banks' solvency and restoring the availability of credit to enterprises and households was rightly regarded as a pre-condition to avoid a total collapse of the financial system, with unpredictable consequences for the real economy. Governments have also announced fiscal stimulus measures – an important step in the right direction.

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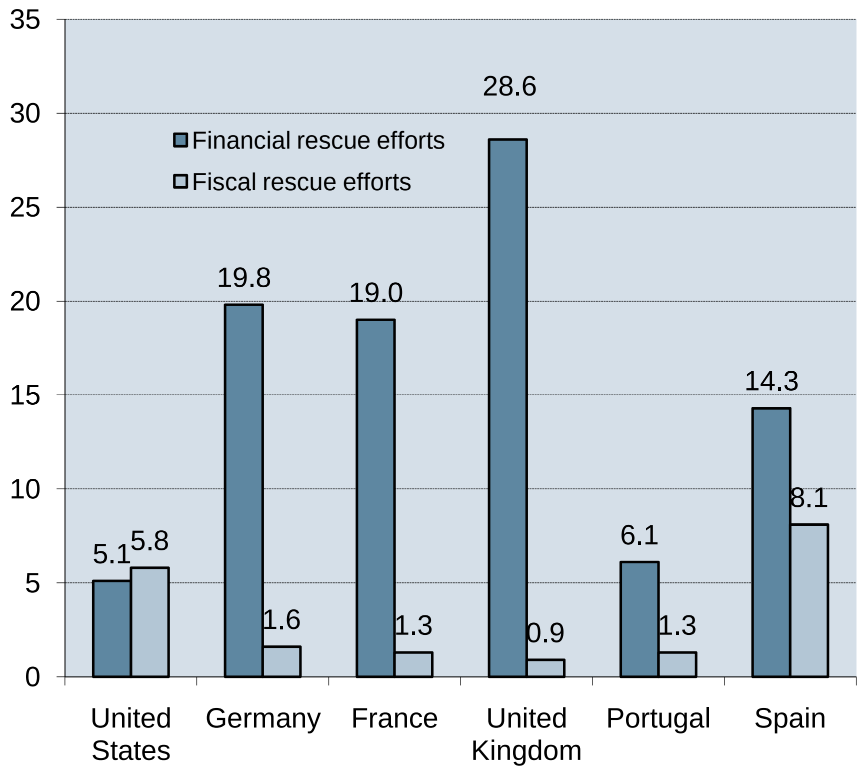
[44] L. Rychly: *Social dialogue on the design and implementation of measures in times of global financial and economic crisis*, ILO, forthcoming 2009.

[45] True, from an accounting point of view, financial rescue packages may not have any impact on the current net debt or budget balance. Measures like capital injection, if treated like a financial transaction, where the government receives in return a financial asset of equal value to the payment, would not affect the budget balance. In fact, the government could theoretically earn income once the markets return to normalcy. Furthermore, buying troubled assets could also prove to be profitable if the government manages to sell them at a higher value. And finally, loan guarantees are not exactly fiscal costs because they might never be exercised or used. Nevertheless, while it is true that comparison between financial and fiscal rescue efforts as a percentage of GDP should not be taken literally, it is very likely that governments will incur costs in rescuing the financial sector which will be far greater than the costs of the fiscal rescue efforts.

86. But there is much debate regarding the desirable content of the packages, their timing, and whether some of the measures should be merely temporary – as championed by the “3 t” approach – or rather, more enduring.[46] The next section addresses these issues.

Figure 10. **Comparison between fiscal and financial rescue efforts as a percentage of GDP**



Source: IILS, based on ILO, OECD & Bloomberg.

[46] According to the “3t” approach, governments should intervene to address the crisis. But interventions should be timely, targeted and – in particular – temporary. The latter means that deviation from market principles should be provisional. Once the economy recovers from the crisis, the state should phase out the measures as quickly as possible.

III. Decent Work as cornerstone of the recovery: A global jobs pact

87. A global jobs pact would be instrumental in overcoming the crisis and paving the way for a more sustainable economy. A *global* approach is needed because the measures, to be effective, need to be coordinated across countries. The emphasis on *jobs* comes from the realization that decent work is central to reactivating the economy in a sustainable manner. This builds on ILO experience with the Global Employment Agenda.[47] Measures are best implemented through social dialogue at the national level, but greater cooperation at the international level can also have mutually reinforcing benefits – thus the need for a *pact*. In this respect, building upon the lessons of the past and avoiding counterproductive measures, such as trade protectionism and generalized wage deflation, will also prove invaluable.

88. More specifically, by putting the Decent Work Agenda at the forefront, a global jobs pact could ensure that stimulus measures more effectively tackle the transmission mechanisms of the crisis, namely the credit crunch, the rapid deterioration in domestic demand conditions and the recession in external markets. A global jobs pact could also address the key factors that nurtured the crisis and lay the foundation for a more sustainable economy.

Reviving the credit system and providing targeted support to sustainable enterprises

89. Experience from previous financial crises suggests that adopting stimulus packages without reviving the credit system may end up raising public debt without stimulating the economy and creating jobs.[48] Furthermore, it has been shown that countries can incur significant fiscal costs because of their failure to tackle problems in the financial system in a timely manner.[49] In light of these lessons, successfully stimulating economic activity will require reactivating credit markets, thus helping businesses to remain viable and be in a position to respond to well-designed fiscal stimulus programmes. A well-functioning financial system is essential for a growing and dynamic private sector. Easier access for SMEs, including cooperatives and start-ups, to financing (such as credit, leasing, venture capital funds or similar or new types of instruments), creates appropriate conditions for a more inclusive process of enterprise development. Financial institutions, particularly

[47] See GB.286/ESP/1(Rev.) and GB.300/ESP/2. Moreover, since 2000, the International Labour Conference has adopted conclusions concerning the following employment themes: decent work and the informal economy (2002); youth employment (2005); the promotion of sustainable enterprises (2007); skills for improved productivity, employment growth and development (2008); and promotion of rural employment for poverty reduction (2008).
[48] The Japanese financial crisis during the 1990s, and the debate about the "lost decade", is a case in point.
[49] C. Reinhart; K. Rogoff: *The Aftermath of Financial Crises*, paper prepared for presentation at the American Economic Association, 2008.

multilateral and international ones, should be encouraged to include decent work in their lending practices.[50]

Re-activating credit to stimulate the real economy …

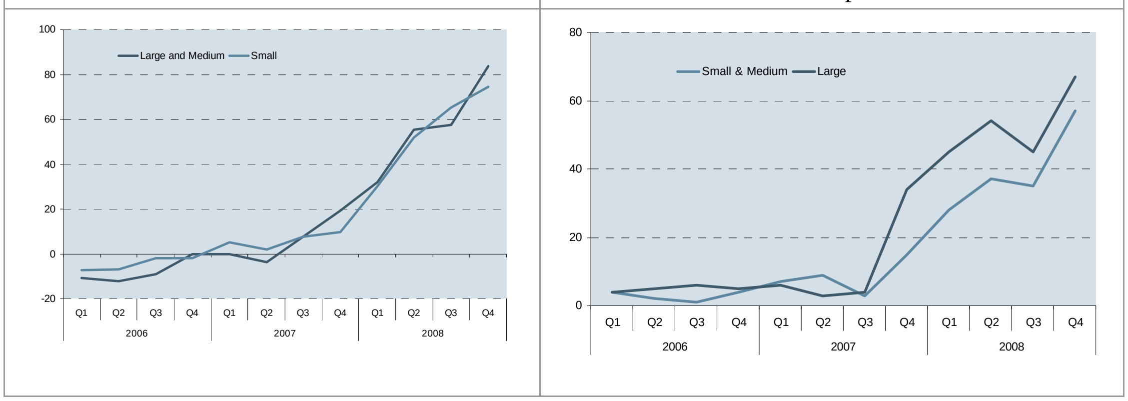
90. Despite the large-scale financial rescue measures, there are indications that banks are reluctant to lend. In the EU and the United States, lending standards have tightened considerably (Figure 11). As a result, individuals and firms have delayed investment decisions, constraining future economic growth and job creation.[51]

91. One factor is that government conditions for support to banks have thus far been weak. Even in countries where banks receiving government support are required to make credit available to businesses, there are no sanctions or penalties for institutions that fail to comply. Banks continue to undergo the process of "deleveraging", i.e. the amount of capital available to the real economy is restricted by banks' efforts to improve their balance sheets and reduce the burden of "toxic assets".[52]

92. Interestingly, in the United States, state-owned banks have shown greater readiness to lend to businesses and consumers than their private-sector counterparts. This might reflect more limited exposure to risky financial operations among state-owned banks. But the fact that these banks are directly accountable to the government may have contributed as well.[53]

Figure 11. Percentage of lenders tightening standards, by size of enterprise seeking loans

Panel A: United States | Panel B: European Union



Source: US Federal Reserve; ECB.

…with targeted support to SMEs …

93. Tighter lending standards present particular challenges for SMEs given their reliance on bank credits – they do not have access to capital markets in the same way larger firms

[50] ILO: Conclusions concerning the promotion of sustainable enterprises, International Labour Conference, Geneva, June 2007, para. 11.

[51] A prolonged investment slump would entail lower capital accumulation, thus reducing productivity gains and limiting the scope for improved living standards in the long-run.

[52] As illustrated in Section II, some government efforts have attempted to address this directly by purchasing or insuring toxic assets in the hopes of improving the lending situation.

[53] Cooperative banks have reportedly pursued their regular lending operations as well (see H. Hagen, 2009, forthcoming).

do. This is why restoring credit conditions in general will have especially favourable effects on small businesses. In the meantime, measures such as special credit lines and direct access to government loans could be envisioned for SMEs to assist them in gaining access to capital.

94. This will be key if SMEs, which account for up to 95 per cent of enterprises and are responsible for most existing and new jobs, are to take advantage of new opportunities that arise from the public investments in infrastructure, construction and housing. The ILO's Small Enterprise Development Programme can play a helpful role in this respect (Box 5).

Box 5. ILO's Small Enterprise Development Programme

The ILO's Small Enterprise Development Programme provides policy advice and support to SMEs in clusters and value chains, particularly those with job creation potential, to improve quality and productivity by enhancing good workplace practices and management-labour collaboration.

The programme also aims to maximize SME involvement in public procurement programmes. For instance, the programme has been assisting governments to administer and supervise contracts for local contractors and training local contractors to tender and deliver such contracts. Such activities are helpful complements to infrastructure programmes carried out as part of the response to the crisis.

Another role of the programme is to assist national and local governments in reviewing and improving the regulatory environment for SMEs. This too can be instrumental in times of crisis.

...and viable sectors through social and "green" conditionality, not protectionism

95. As noted in the first section of this paper, the crisis is hitting certain sectors harder than others. Export-oriented sectors are particularly vulnerable to both the credit squeeze, given their reliance on trade finance, and the spectacular fall in world demand and commodity prices.

96. Governments are thus under growing pressure to provide assistance to these sectors. Some countries have already increased import duties on automobile parts or steel. Others have imposed caps on imports of certain products, like chemicals or wood. Yet others have added "buy national" provisions in their fiscal stimulus plans. These types of measures can incite other countries to retaliate, or adopt counterbalance measures. Moreover, history shows that in the long-run protectionist measures are likely to create more substantial employment and income losses.

97. Instead, there are ways to support the long-run viability of industries by, for example, re-orienting them towards greener technologies that would: help stimulate economic activity by facilitating industrial restructuring; support sustainable employment creation; and prepare for the transition to a less CO2-intensive economy. One way to achieve this would be to provide assistance to certain sectors conditional on social and environmental

objectives.[54] The importance of synergies between investments in clean technologies and job creation has been recognized at the international level through the creation of the Green Jobs Initiative. The ILO has an important role to play in this initiative, along with its partners (United Nations Environment Programme, the International Trade Union Confederation and the International Organization of Employers) to ensure that green jobs become a positive driver of development in an environmentally, socially, and economically sustainable future (see also the last section of this paper).[55]

Boosting the economy through employment-oriented, coordinated actions

98. Despite the numerous stimulus packages introduced to date, aggregate demand continues to worsen. As noted above, part of the problem may be that efforts to address the challenges have been insufficient in magnitude. In fact, some of the "new" public spending is a repackaging of previously committed funds. Countries are reluctant to announce bold measures however because they are worried they will "leak" into the economies of their trading partners – a situation that is exacerbated, in some cases, by already deteriorating fiscal positions. This underlines the importance of measures that are coordinated across countries.

Stimulus packages need to be timely and better coordinated…

99. The complexities of the decision-making process may delay the adoption of stimulus packages. However, if unduly delayed, measures may come at a time when the recession is well underway and packages may prove insufficient or ill-adapted to the evolving circumstances. Success in overcoming earlier financial crises in Korea and Sweden is associated with the prompt adoption of a stimulus package. According to a simulation developed for the purpose of this paper, and assuming that credit markets were restored, it would take one year for the United States economy to recover if the "Obama package" was implemented now. And, according to the estimates, it would take almost two years if implementation of the package were delayed by three months.[56]

100. Better coordination of fiscal stimulus packages could also enhance the impact on global demand. There are cross-border externalities to the financial and fiscal rescue packages. Capital injections by the United States authorities would help alleviate the European financial crisis and vice versa. Likewise, a fiscal stimulus put forward by the Chinese government helps its trading partners and vice versa. Coordination is especially important in countries where fiscal space is limited as in the case of many African countries. In the absence of coordination in their response, these countries may be tempted to engage in a process of competitive devaluations or, worse, wage deflation. Coordinated action will also help boost world demand, hence cushioning the effects of a global recession.

[54] For example, France's plan to support its auto industry includes requirements that funding be used to invest in green technologies and that no layoffs would occur in 2009.

[55] ILO: "Green Jobs Initiative", available at http://www.ilo.org/integration/greenjobs.

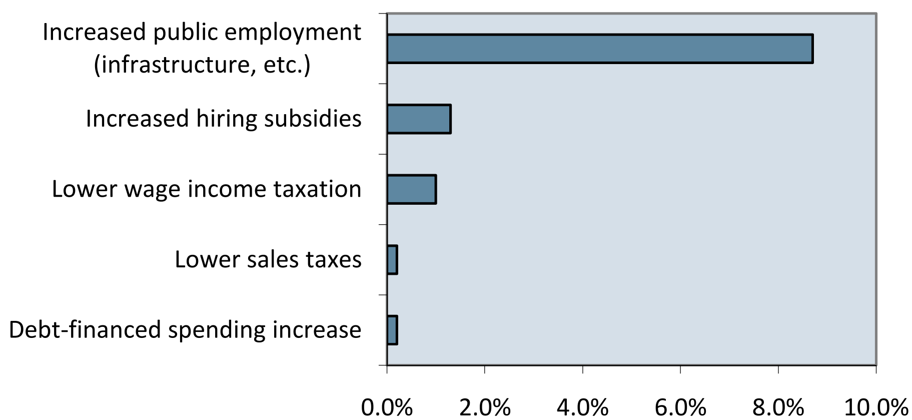
56 E. Ernst; M. Charpe: *Global economic linkages: Labour market implications of macroeconomic and social policies in open economies*, IILS, ILO, forthcoming 2009.

...with a strong focus on employment…

101. One of the lessons of the analysis carried out for this paper is that the greater the employment orientation of the measures, the stronger the stimulus for the real economy. As shown in figure 12, measures that have a direct impact on employment have a stronger effect than relatively untargeted measures (such as VAT cuts, or across-the-board spending increases).

102. In particular, the multiplier effects of investments in employment-intensive areas will be higher than is the case with alternate measures such as tax cuts.[57] At times of crisis, when there is considerable labour market slack, job-rich investment can crowd-in private sector activities and, more fundamentally, unlock development potential and pave the way for higher long-term growth. In this regard, public investments in infrastructure and agricultural development represent a major opportunity to address both employment and development challenges. These can include, among other things, investments in roads and communication, flood control and public buildings for education. To effectively lead to higher employment however, infrastructure projects need to meet existing domestic supply and skills.

Figure 12. Estimated employment effects of different fiscal measures*



* The figure shows the estimated employment effects of different fiscal measures. Each measure represents the equivalent of 5.7 per cent of GDP – the size of the stimulus package recently-adopted in the United States. For instance, it shows that employment would increase by up to 8 per cent in the long-run, if the entire package focused on public employment programmes such as infrastructure spending. Importantly, the estimates assume that new hires have the skills to perform the jobs created by the programmes. They also assume that sufficient domestic supply is available to respond to government incentives.

Source: IILS estimates.

57 A. Spilimbergo; S. Symansky; O. Blanchard; C. Cottarelli: *Fiscal Policy for the Crisis*, IMF Staff Position Note, IMF, 29 December 2008 (SPN/08/01). Stimulus aimed at consumers is potentially uncertain and limited, and direct subsidies to domestic firms have international trade law consequences and could lead to an uneven playing field and even trade wars (*ibid*).

103. Employment guarantees are another employment-intensive measure which, as experience from earlier crises shows, can be especially cost-effective in the face of the crisis – if well-designed and targeted:[58]

- Argentina’s *Jefes y Jefas de Hogar Desocupados* programme, introduced during the 2001 crisis, reduced aggregate unemployment by an estimated 2.5 percentage points, increased labour force participation and reduced extreme poverty.59
- Similar pubic works programmes in Indonesia, Republic of Korea and Thailand adopted after the East Asian financial crisis, proved to be relatively successful in employing large numbers of individuals. However, studies suggest that programmes could have been more effective if better designed and monitored.60
- The National Rural Employment Guarantee (NREG) of India provides an important safety net for many rural households. The programme aims to provide additional employment to the underemployed and the unemployed by entitling every rural Indian household to 100 days of work per year. The budget for the NREG in 2006-07 was 0.33 per cent of GDP.61

104. In developed countries where most of the jobs are formal, supporting employment through partial unemployment benefits or subsidies for shorter working hours can prove effective. Such measures are being used extensively in some European countries. (see also Box 10 below for examples of experiences during the Asian financial crisis).

…supported by efforts to promote workers’ skills...

105. To be successful, employment-intensive investments need to go hand-in-hand with efforts to promote skills development. In many cases, new skills will be needed in order to match the requirements of new infrastructure spending and programmes designed to support sectoral transition, e.g. towards greener technologies. In this regard, the design of such programmes is fundamental to ensure success due to the time required to adjust training provisions accordingly. Implementing time- and cost-efficient methods to identify current and future skills demands become crucial. The conclusions of the 2008 International Labour Conference discussion on Skills for improved productivity, employment growth and development can help in this regard.

[58] G. Márquez: *Labor Markets and Income Support: What Did We Learn From the Crises?,* Working Paper No. 425, Inter-American Development Bank, 2000; B. Cook: *Active Labour Market Policies in the Neo-Liberal Era*, Working Paper No. 08-03, Centre of Full Employment and Equity, 2008. Wage levels are very important in ensuring successful employment guarantees and public works. If wages are too high, they will distort the labour market and pull individuals (particularly the non-poor) from employment. High wages will also put pressure on programme funding and likely result in the rationing of jobs. On the other hand, if wages are too low, programmes will not be an effective safety net for participants and may become stigmatizing.

[59] E. Galasso; M. Ravallion: “Social protection in a crisis: Argentina's plan *Jefes y Jefas*", in *The World Bank Economic Review*, Vol. 18, No. 3, 2004, pp. 367-399.

[60] G. Betcherman; R. Islam, *East Asian labor markets and the economic crisis: Impacts, responses and lessons*, World Bank and ILO, 2001.

[61] P. Chakraborty: *Implementation of the National Rural Employment Guarantee Act in India: Spatial Dimensions and Fiscal Implications*, The Levy Economics Institute of Bard College, Working Paper No.505, 2007.

…and help jobseekers through effective public employment services and active labour market programmes

106. Active labour market programmes play an important role in skills development and more broadly in facilitating the adjustment of individuals to changing labour market conditions. Such programmes can take many forms, including: job-search assistance and monitoring, personalized action plans for job seekers, training, and targeted programs for disadvantaged groups. They can also provide much needed income support. If properly designed, they can enhance employability and improve labour market mobility in the short term. They can further facilitate matches between the skills of displaced workers and the skills required in the jobs created by new public investment (e.g. in construction, infrastructure and alternative energy).

107. Some lessons learned to date about enhancing the effectiveness of active labour market programmes include: an obligation on the part of the benefit recipient to undertake an activity and enforcement of this obligation by the programme; making participation in programmes compulsory; targeting increased effectiveness of outcomes, programmes and services (e.g. combining training and job-search assistance); and in-work benefits help facilitate a return to work.[62]

108. During a crisis, special programmes to assist displaced or retrenched workers should be intensified. The ILO *Guide to Worker Displacement: Some tools for reducing the impact on workers, communities and enterprises* demonstrates the wide range of possible responses by enterprises, communities and workers to economic downturns and how to reduce potential job losses. Schemes targeting temporarily laid-off workers can be very efficient, since workers with firm-specific training are often expected to return to work at the same firm (or sector) when the business climate improves. This type of programme could complement the employment-intensive public investments and initiatives to extend, or enhance, unemployment benefit coverage. This may mean allocating additional resources to public employment services. Already, some national employment services have been mobilized to help address the global economic crisis (Box 6).

Box 6. Enhancing public employment services and active labour market programmes

France: *Pôle Emploi*, the newly created agency that merges employment services and unemployment insurance, is increasing the resources available to enhance employment services, facilitate training for jobseekers and support the effort of social partners to coordinate measures to address the financial crisis.

Mexico: the *BÉCATE* programme of the National Employment Service is being expanded to provide various training programmes, including apprenticeships, which include monthly financial support for trainees and counselling on how to start a business.

Philippines: *Public Employment Service Offices* (PESOs) have been mobilized to intensify job placement, emergency employment and livelihood formation services, particularly for workers in commodity and export industries.

[62] See for example, OECD: *Employment Outlook*, Paris, 2005; M. Rosholm; M. Svarer: *Estimating the Threat Effect of Active Labour Market Programs*, Discussion Paper No. 1300, Institute for the Study of Labor, 2004; M. White; R. Riley: *Findings from the Macro Evaluation of the New Deal for Young People*, DWP Research Report No. 166, Centre for Development Studies, University of Leeds, 2002.

Republic of Congo: An anti-crisis strategy has been put in place, monitored by an inter-ministerial committee. It includes a programme to upgrade the skills of both employed and unemployed workers in a way that responds to labour market requirements.

109. Greater use of active labour market programmes could also be foreseen for some developing and emerging countries. A recent study shows that some 12 out of 31 economies in Latin America and the Caribbean are indeed already using active and passive labour market policies in response to current economic circumstances.[63] The cost of new programmes is relatively low. For example, Argentina's spending peaked at about 1 per cent of GDP. Based on this cost level, such programmes could be an appropriate tool if there is political will by policy makers.

Leveraging local partnerships to enhance effectiveness

110. The effectiveness of employment-intensive investments, skills development and active labour market programmes can be improved by leveraging capacity among local partners – the foundation upon which the ILO's employment-intensive investment programme is built (Box 7).

Box 7. The ILO's Employment-intensive Investment Programme

The ILO's Employment-intensive Investment Programme works with governments, employers' and workers' organizations, the private sector and community associations in orienting infrastructure investments towards the creation of higher levels of productive employment, as well as towards the improvement of access to basic goods and services for the poor. Many of the programme's projects rely on labour-based technologies, in order to generate local employment and incomes and develop skills.

Labour-based technologies have several benefits: they are between 10 and 30 per cent less costly than more equipment-intensive options; foreign exchange requirements are reduced by about 50 to 60 per cent; between 2 and 4 times more direct employment opportunities are created for the same investment; indirect employment ranges between 1.5 and 3 times the numbers of direct jobs stemming from the initial investment. Over the last 30 years the programme has played a vital role in over 60 countries in Africa, Asia and Latin America in dealing with job creation and poverty reduction in rural and urban areas. It has also developed methodologies to ensure cost effectiveness of the measures.

Enhancing social protection, especially among low-income groups

111. As earlier sections illustrated, as the crisis unfolds, the risks that individuals around the world are facing are exacerbated by limited access to social security schemes and social safety nets. At the same time, in countries where such schemes do exist, pressures on their finances, e.g. pension systems, are intensifying as countries experience the double burden of declining tax contributions and increasing expenditures due to rising claims.

Well-designed social policies can alleviate the consequences of the crisis in the short run…

112. Supporting workers and their families through well-designed social policies – a core ILO competency – is a key component to averting a social crisis and stimulating the

[63] Economic Commission for Latin America and the Caribbean, 2008.

economy more broadly.[64] Neglecting victims of the crisis, and of the interconnecting food, energy and poverty crises, would be unfair and could undermine support for government rescue plans. Moreover, supporting low-income groups, which typically have a high propensity to consume, would help stimulate aggregate demand and restore confidence.

…by helping low-income and other vulnerable groups while supporting the recovery…

113. One way to provide assistance to individuals is to widen eligibility conditions and increase benefit amounts of existing social security schemes, e.g. by extending the duration or increasing the generosity of unemployment benefits (see Table 4 for examples of countries that have already done this). In the absence of existing schemes, however, it may be necessary to introduce new measures to help low-income and other vulnerable groups.

114. For example, income support measures such as conditional cash transfers could be further strengthened (or introduced) to enhance human capital and access to education and health services, especially for the poor (see Box 8). This is particularly relevant given that in many low-income countries, crises are associated with poorer health and education outcomes for children, while in middle-income countries, they are associated with poorer health outcomes.[65] Investments in children's education and health services also have a long-term systemic impact on poverty levels. Social and care services also provide job opportunities for women who may not be able to take up construction work on infrastructure projects.

Box 8. Conditional cash transfers

Conditional cash transfers provide cash to poor families linked to certain educational and health-related conditions. The most common conditions focus on children's school attendance, health care check-ups and nutrition. Recent studies show that one-third of developing countries have implemented some kind of cash transfer programmes.

Conditional cash transfers have been effective at smoothing recipients' consumption during times of crisis. For example:

- In Nicaragua, during the Central American coffee crisis, they smoothed consumption, protected children's school enrolment, reduced child labour and improved health outcomes.
- Similarly, in Honduras, they allowed families to keep their children in school during the crisis.
- They were also successfully introduced as part of earlier crisis responses in Colombia and Turkey.
- Indonesia's scholarship and school subsidy programme was introduced in 1998 as a part of the government's crisis response.[66]

[64] See for example E. Lee: *The Asian Financial Crisis: The Challenge for Social Policy,* ILO, 1998.

[65] Children's human capital outcomes are not uniformly affected in a crisis. For instance, during economic or environmental crises, health outcomes suffered in the Philippines and Uganda, while education outcomes were not dramatically affected in Brazil, Indonesia and Uganda (see E. Skoufias: "Economic Crises and Natural Disasters: Coping Strategies and Policy Implications", in *World Development*, Vol. 31, No. 7, 2003, pp. 1087–1102). World Bank: *Lessons from World Bank Research on Financial Crises*, Policy Research Working Paper No. 4779, 2008

[66] For some evaluations of these programmes, see van W. Ginneken: *Managing risk and minimizing vulnerability: The role of social protection in pro-poor growth*, ILO, 2005; S. Handa; B. Davis: "The Experience of Conditional Cash Transfers in Latin America and the Caribbean", in *Development Policy Review,* Vol. 24, No. 5, 2006, pp. 513-536; L. Rawlings; G. Rubio: "Evaluating the impact of conditional cash transfer programs", in *The World Bank*

115. In cases where conditional cash transfers do not exist, establishing a new programme can be a complicated, time-consuming and administratively challenging process, entailing considerable data-collection and monitoring capacity which may be difficult to mobilize in times of crisis. Consequently, in low-income countries where poverty is widespread and administrative capacity limited, unconditional transfers could be considered as a way to enhance universal social protection.

116. A wide range of other tools and targeted intervention programmes could be envisioned to support vulnerable groups such as workers in the informal sector and rural areas, e.g. the labour-intensive public works programmes as undertaken by many governments during crises (Argentina, Indonesia, Republic of Korea and Thailand). As discussed above, employment guarantee programmes of this nature can potentially combat both poverty and unemployment with positive secondary effects on, among other things, health, crime and political stability. Other types of income and employment entitlement programmes, such as those offered by the Self Employed Women's Association in India or the Grameen Bank in Bangladesh, could also help provide much needed social protection to vulnerable groups in times of crises. For programmes targeting informal workers, particular attention to the gender dimension will be crucial.[67]

…and protecting pensions from the volatility of stock markets

117. In order to avoid losing ground both against existing poverty thresholds and the rates of replacement income provided, it is necessary to restore solidarity-based minimum guarantees of pension amounts underwritten by the State, and protect the pension levels of individuals who are close to retirement. In certain countries (such as India), the elderly rely heavily on income from savings, which is likely to be severely curtailed with current interest rate drops. In addition, in countries that rely on annuitization of individual savings accounts, any prolonged suppression of interest rates is likely to lead to serious difficulties because of increased volatility in annuity rates (prices).

118. As a transition measure, a minimum pension based on a reasonable minimum rate of return ought to be financed or guaranteed by the State. Governments could also authorize pension schemes to reduce their levels of capitalization. One possible approach is to allow schemes to go into temporary actuarial deficit. If asset prices rebound in due course, then the ultimate net cost of such guarantees would be only a fraction of the momentary losses of pension assets.

Research Observer, Vol. 20, No. 1, 2005, pp. 29-55; and R. Sparrow: "Protecting Education for the Poor in Times of Crisis: An Evaluation of a Scholarship Programme in Indonesia", in *Oxford bulletin of economics and statistics*, Vol. 69, No. 1, 2007, pp. 99-122.

[67] A. King-Desjardin; *Gender dimensions of globalization*, discussion paper presented at the Oslo Conference on Decent Work: A key to Social Justice for a Fair Globalization, 4 September 2008.

119. The OECD has suggested that governments could play a more active role in managing the risks associated with the payout phase of pensions and annuities. In particular, governments could encourage the development of longevity-hedging products by producing an official longevity index. Other proposals include suggestions for governments to issue longevity bonds that "would set a benchmark for private issuers", while also giving consideration to issuing more long-term and inflation-indexed bonds – a move already taken by a small number of countries, most recently the Danish government, which released a 30-year bond that was primarily bought by domestic pension funds and insurance companies.

But these measures should form the basis of a broad-based social protection for all…

120. While the above measures to protect the most vulnerable are important steps to addressing current challenges, they should form part of a systematic effort to develop a broad-based social security system (covering social assistance, education, health, unemployment benefits, etc.) and an overall poverty reduction strategy.

… which can help mitigate the impacts of future crises…

121. Experience in several European and, more recently, some Asian countries has shown that a system of basic social security can mitigate the impacts of crises by means of automatic stabilizers – measures of support that automatically increase during times of crises or increased household vulnerability.

…and, if consistent with employment goals, support development objectives

122. Moreover, increases in social spending do not impede growth. On the contrary, if social protection is designed in a way that takes into account work incentives, it can boost the quality of growth through its pro-poor elements. For example, countries that have high social spending also tend to have lower levels of poverty and inequality.[68] In other words, social security measures should, and can, be designed in such a way as to go hand in hand with economic policy to increase production, social protection and redistribution while addressing broader social issues such as family, care and poverty.

123. Just as the Great Depression was a defining moment in the United States in creating the Social Security Act (1935) and the financial and economic crises of the 1990s were defining moments in Asian and Latin American social policy innovation, this current crisis should be taken as an opportunity to enact much-needed reforms to social security systems. In this respect the Social Security (Minimum Standards) Convention, 1952 (No. 102) can guide efforts to strengthen social security systems.

Protecting the rights of workers

124. In attempting to address the challenges associated with the crisis, it is crucial to ensure that workers' rights and international labour standards are not compromised in the process. In fact, the observance of fundamental principles and rights at work must be part of the solution to the crisis. Moreover, respect for fundamental principles and rights at

[68] ILO: *World of Work Report 2008.Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.

work is necessary to maintain social justice and peace, and to avoid political unrest which could create even greater delays in terms of a recovery.

Reduced labour standards would be both unfair and counter-productive…

125. Some argue that labour market rigidity and overly stringent labour standards restrict the capacity of an economy to cope with economic shocks and that labour market flexibility can temper both the depth and duration of unemployment in the current crisis.[69] However, there is considerable evidence drawn from cross-country studies that illustrates that there is no clear relationship between fewer labour regulations and faster economic and employment growth.[70] Efforts that are focused exclusively on speeding up the labour market adjustment process to cope with the global economic crisis run the risk of impairing long-term growth potential.

126. Maintaining labour standards helps support confidence and thus contributes to activating the economy. Moreover such measures would be equitable and enable vulnerable workers to deal with labour market risks, thus enhancing popular support for recovery packages. The different national situations now arising in the context of the crisis highlight the relevance of the ILO's full complement of instruments to protect workers' rights (see Box 9).

Box 9. Relevance of ILO instruments in the crisis context

The ILO has a comprehensive set of instruments to protect workers' rights. The following are examples of the relevance of these instruments in the context of the crisis:

- As pressures on firms mount, the Protection of Wages Convention, 1949 (No. 95) and the Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173), along with their associated Recommendations, lay out constructive measures for protecting workers' wages and proceeding fairly in cases of an employer's insolvency. Where lay-offs arise, it is important to ensure that terminations are not discriminatory on any of the grounds provided in the fundamental Conventions. The Termination of Employment Convention, 1982 (No. 158) and Recommendation (No. 166) shed light on how terminations can take place in a balanced manner. The provisions of the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) could be particularly useful in managing the effects of the recession along global supply chains. To protect the employment security of workers in atypical employment situations, the Employment Relationship Recommendation, 2006 (No. 198) is salient.
- Instruments concerning migrant workers (the Migration for Employment Convention (Revised), 1949 (No. 97) and the Migrant Workers (Supplementary Provisions) Convention, 1975 (No. 143)) are also highly relevant, given that this group is particularly vulnerable in the context of the downturn in labour markets.
- The Labour Clauses (Public Contracts) Convention, 1949 (No. 94) can help ensure that investments financed by public stimulus packages generate jobs with decent pay and working conditions.
- In the context of enhancing social protection, the eight fundamental Conventions (Forced Labour Convention, 1930 (No. 29); Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87); Right to Organise and Collective Bargaining Convention, 1949 (No.

[69] This is under the assumption that in rigid labour markets, relative prices (wages in this case) are sticky, and therefore the brunt of the adjustment process is borne via the depth and duration of unemployment.
[70] J. Berg; D. Kucera: *In defence of labour market institutions. Cultivating justice in the developing world*, ILO, Geneva, 2008; A. Ghose; N. Majid; C. Ernst: *The Global Employment Challenge*, ILO, Geneva, 2008; Baker *et al.: Labour market institutions and unemployment : A critical assessment of the cross-country evidence*, 2005.

98); Abolition of Forced Labour Convention, 1957 (No. 105); Equal Remuneration Convention, 1951 (No. 100); Discrimination (Employment and Occupation) Convention, 1958 (No. 111); Minimum Age Convention, 1973 (No. 138) and Worst Forms of Child Labour Convention, 1999 (No.182)) can guide poverty alleviation efforts and, along with Convention No. 102, efforts to strengthen social security systems. Fundamental Conventions are crucial to ensuring a more balanced distribution of the gains from economic growth and reducing excessive inequalities –a key factor behind the crisis.

- Social dialogue mechanisms and processes, as outlined in the Tripartite Consultation (International Labour Standards) Convention, 1976 (No. 144), and the Tripartite Consultation (Activities of the International Labour Organisation) Recommendation, 1976 (No. 152), as well as in the Consultation (Industrial and National Levels) Recommendation, 1960 (No. 113) and the MNE Declaration, need to be part of the strategy.
- Overall, the Employment Policy Convention, 1964 (No. 122) – based on policies for full, productive, and freely chosen employment – can provide a useful overarching framework for international action.

… and the crisis represents an opportunity to emphasise the role of workers' rights

127. The crisis should be taken as an opportunity to reinforce the value of protecting and respecting workers' rights.[71] Measures should be taken to guarantee impartial and efficient judicial, as well as extra-judicial, proceedings dealing with individual and collective disputes. Labour inspection and administration systems should be reinforced to guarantee implementation of measures taken to combat the crisis and its social consequences and to provide services to employers and workers. Public employment services and labour inspection have a special responsibility in this regard.

128. Better enforcement of workers' rights could help achieve more balanced income developments and thus reduce the risk of future crises.[72] A consistent finding is that countries that have 'labour-friendly' regulations seem to be associated with lower wage inequality – a tangible social benefit – without imposing any significant loss in terms of output and employment.[73] A rights-based approach to the crisis can thus anchor the discussion of policy options, to enhance social justice in the immediate and longer term.

The role of social dialogue and wage determination

Social dialogue plays an essential role in protecting rights and achieving employment objectives …

129. The Declaration of Philadelphia established the ILO's commitment to social dialogue, tripartism and participation. Its central importance has been sustained over the decades. More recently, in 2002, the International Labour Conference adopted a resolution concerning tripartism and social dialogue, recognizing that social dialogue plays an essential role in the achievement of employment objectives and the improvement of social protection. Social dialogue can be instrumental in adopting

[71] L. Rychly: *Social dialogue on the design and implementation of measures in times of global financial and economic crisis*, ILO, forthcoming 2009.
[72] J. Berg; D. Kucera: op.cit.
[73] See for example, R. Freeman: *Doing the Right Thing? Does Fair Share Capitalism Improve Workplace Performance?: Analyzing Effects in Britain*, with Alex Bryson, presented at the Shared Capitalism Research Conference, NBER-Sage Foundation, 6-7 October 2006.

effective, concrete policy responses by helping to improve the design of reforms, and it can help to bolster support for reforms in general.[74]

… social partners can be instrumental in designing and implementing reforms for overcoming the crises...

130. At the 8th European Regional Meeting of the ILO (Lisbon, February 2009) participants emphasized the significance of social dialogue as a key means of developing strategies to counter the recession and secure the commitment of governments, employers and unions for implementation of the strategies.[75] Indeed, examples from past crises can be identified which illustrate how national tripartite consultations have played an important role in overcoming severe economic difficulties. For example, in Singapore measures were introduced to mitigate excessive layoffs, whereas in the Republic of Korea, eventual agreement improved the government's crisis-management capacity, and was instrumental in reaching national consensus (Box 10).[76] In addition, Argentina's post recovery process was based on a social pact bringing all the social partners together.

Box 10. **Lessons from social dialogue in previous crises**

Singapore: To counter the 1997-1998 financial crisis, the government introduced new labour policies. In particular, as a result of a tripartite agreement, employers received financial incentives if they avoided layoffs. Tripartite institutions as well as ad hoc tripartite agreements were very effective in articulating conflicting interests between the three parties, resulting in more effective formulation and implementation of social and economic policies.

Republic of Korea: To respond to the 1997-1998 financial crisis, a Tripartite Commission was created. The Commission had two major objectives: to contribute to economic restructuring and to involve social partners in the revision of Korean labour law, in line with ILO standards. A Social Agreement adopted by social partners in February 1998, accepted layoffs of redundant labour force as an economic reality, but it also significantly enlarged workers' basic rights, substantially expanding freedom of association and the right to bargain collectively, both in the private and public sectors. This "Great Compromise" improved the government's crisis-management capacity, and was instrumental in reaching national consensus and helping the country overcome the credit crunch.

…and finding pro-decent work solutions to immediate and longer-term challenges…

131. At the national level, the existing institutional framework, as well as newly established consultative bodies, should be used to identify and implement appropriate national policies. Where these bodies do not exist, *ad-hoc* high-level meetings should be held to exchange information and to consult or negotiate policy measures. In difficult times, it is of particular importance to build and maintain mutual trust between the State and the social partners and among the social partners themselves. The ILO can play an important role in this context. Social dialogue and collective bargaining are powerful tools to cope with immediate challenges of the crisis, such as preventing social unrest, avoiding damaging industrial actions, reducing income inequalities and maintaining

[74] See L. Rychly: op.cit.
[75] See GB.304/14/4.
[76] For a comprehensive discussion of social dialogue in the post-crisis context, see D. Campbell: "Social Dialogue and Labour Market Adjustment in East Asia after the Crisis", in G. Betcherman, R. Islam, (eds.): *East Asian labor markets and the economic crisis: Impacts, responses and lessons*, World Bank and ILO, 2001.

social cohesion. Through improved governance social dialogue can also pave the way for shared prosperity and stability in the longer term.[77]

… especially as regards wage developments – a particularly contentious issue

132. One point of contention is wage-setting practices. In particular, some advocate wage moderation in an attempt to cut costs and prevent job loss in ailing firms. Others argue for maintaining purchasing power and aggregate demand.

Overall, to sustain the recovery, average real wages should grow in line with productivity and minimum wages should not fall…

133. Paradoxically, both views are probably valid. On the one hand, firms are facing significant financial difficulties and their viability, including that of the employees, may rely on significant cost reductions. Such reductions, which take the form of, among others, wage freezes or cuts – perhaps even in line with productivity declines –can help firms survive and avoid layoffs.[78] In addition, earlier experiences in Asia and Latin America show that lower wages played a strategic role in the response to the crisis. Lower wages, together with currency devaluations, resulted in massive improvements in external competitiveness. The latter, in turn, was instrumental in the recovery of these countries.

134. On the other hand, given the global nature of the current crisis, a generalization of wage restrictions in the name of competitiveness and better profitability would most likely push the world economy into further trouble. This is a real risk. Indeed, excessive wage developments are not the cause of the crisis. In fact, evidence suggests that real wages have tended to grow *below* productivity gains since the early 1990s.[79] On average, pre-crisis profit rates were high by all standards. So, unlike the crisis of the early 1980s, low profitability has not been the main problem for most enterprises. In addition, stagnant median wages and incomes were an enabling factor behind excessive debt accumulation.

135. Altogether, as a response to the crisis as well as from a longer term perspective, it would be economically desirable – as well as fair – if average wages would grow over the medium-term in line with productivity gains, taking into account firms' viability in the short-run. In light of the evidence to date, this may mean that wages may need to rise faster during economic upswings and less rapidly during downswings.

136. In this respect, the role of collective bargaining and social dialogue will be critical to achieving a desirable outcome. Employers and workers need to be encouraged

[77] Countries with coordinated collective bargaining have been shown to have less wage dispersion compared to other countries. T. Aidt; Z. Tzannatos: *Unions and Collective Bargaining: Economic Effects in a Global Environment*, World Bank, Washington, 2002.
[78] Other measures to avoid job loss were discussed throughout the report.
[79] ILO: *Global Wage Report,* November 2008; ILO: *World of Work Report 2008. Income Inequalities in the Age of Financial Globalization,* IILS, Geneva, 2008.

to participate in collectively negotiated wage-setting practices. Governments can help stimulate dialogue and facilitate concerned action to avoid socially undesirable, and potentially inefficient, generalized wage reductions. Moreover, collective bargaining can reduce overall wage inequality and ensures a stronger link between economic growth and average wages.[80]

137. Governments can support this process through minimum wage legislation, adjusted regularly to maintain the purchasing power and avoid sudden adjustments, which are detrimental to job creation. The Minimum Wage Fixing Labour Convention, 1970 (No. 131) provides an important benchmark in this regard.

[80] ILO: *Global Wage Report*, November 2008.

IV. Improving global policy coherence for more balanced growth and development

138. The need for greater global policy coherence has been emphasized many times, and for good reasons. But it is especially important now. Unless greater international coordination is achieved in the responses to the crisis, the world economy will face the prospect of a protracted economic crisis, entailing an even deeper labour market crisis and significant social hardship. Greater coherence is also needed at the global level. No international organization or country has the mandate for, or is equipped to treat, all facets of the crisis and its underlying challenges. This is why the G20 has emerged as a key forum to discuss the crisis.

139. The ILO has therefore committed itself to fostering greater cooperation among national governments, international organizations, and other stakeholders in support of a stronger, cleaner and fairer economy.[81] It is important to build on complementarities between the ILO and the different mandates of other international organizations – particularly the World Bank, the IMF, the WTO, and the United Nations Environment Programme, among others – to enhance coherence between economic, financial, trade, social, environmental and development goals.

Avoiding in-ward looking and protectionist solutions

140. The global crisis will not be solved by protectionist solutions. Rather, such solutions would depress world trade and investment, further aggravating the recession. Historical evidence from the Great Depression shows that attempts to restore economic stability by closing borders to trade are bound to fail and would generate even more substantial income and employment losses in the long-run. The repercussions for developing countries, which rely so heavily on world markets, would be especially acute.

141. The role of the multilateral system is critical and it will be important to remain vigilant vis-à-vis the mounting pressure to support strategic sectors like automobiles. Support should be temporary and tied to social and environmental conditions. To complement this, however, it is of paramount importance to help workers adjust, through a variety of training and re-employment measures as discussed earlier.

142. Likewise, attempts to overcome the crisis through competitive currency devaluations would be counterproductive. Some countries have already had recourse to strong devaluations. In some cases, this may be justified on the basis of economic fundamentals. However, currency devaluations with the aim of improving competitiveness will not help overcome the global crisis and may aggravate trade

[81] See the joint press release by Chancellor Angela Merkel, OECD Secretary General Angel Gurría, WTO Director-General Pascal Lamy, ILO Director-General Juan Somavia, IMF Managing Director Dominique Strauss-Kahn and World Bank President Robert B. Zoellick on the occasion of their meeting on 5 February 2009 in Berlin.

tensions. Here too, an orderly adjustment, through proper international cooperation is clearly desirable.

143. Generalized wage deflation to protect individual economies would aggravate the crisis even more than a wave of competitive devaluations. Indeed, wage deflation would deprive the world economy of much-needed demand and would also seriously affect confidence. Open market policies, which are so crucial to the recovery, would also face a risk of backlash if workers perceive the measures as unfair.

Reforming the financial architecture so that it serves the needs of the real economy…

144. Medium and long-term measures to overhaul the financial regulatory framework are required to move towards a more stable global financial system. Previously widespread practices – such as excessive leveraging, opaque financial instruments and executive compensation schemes – need to cease.[82] In a few cases, limits on executive pay and bonuses have been instituted as a condition for government assistance. But a more profound change is clearly called for.

145. Indeed, despite the coordinated international responses in the short-run, the global financial system is likely to remain marked by volatility until significant structural adjustments are made. Therefore, in all countries, it will be crucial to reinforce prudential regulation to reduce excessive and irresponsible short-term risk-taking on the part of certain financial actors. For instance, lightly regulated markets for financing mechanisms such as private equity, hedge funds and non-bank financing have been held responsible, in part, for sudden herd-like in- and out-flows of funds in certain industries and sectors which may have magnified the effect of the current crisis. A cautious approach to regulation is especially important in countries where financial markets are not sufficiently developed and where supervision mechanisms are weak. The "de Larosière report" provides a rich menu of how to move forward in this regard.[83]

…and takes into account the social impacts of different reform options

146. The regulatory reforms made in the coming months and years must be assessed against their social impacts and implications for employment growth. As the International Labour Conference emphasized in 2007, financial services can indeed be used to promote decent work outcomes, if regulated appropriately.[84] Any new financial system should therefore give incentives for productive investments in sustainable enterprises and decent work, and disincentives to short-term speculation.

147. In this regard, the ILO has an important role in highlighting the social impacts of the reforms to strengthen the inclusiveness of a new financial architecture and help the international community strike the right balance between government regulation and

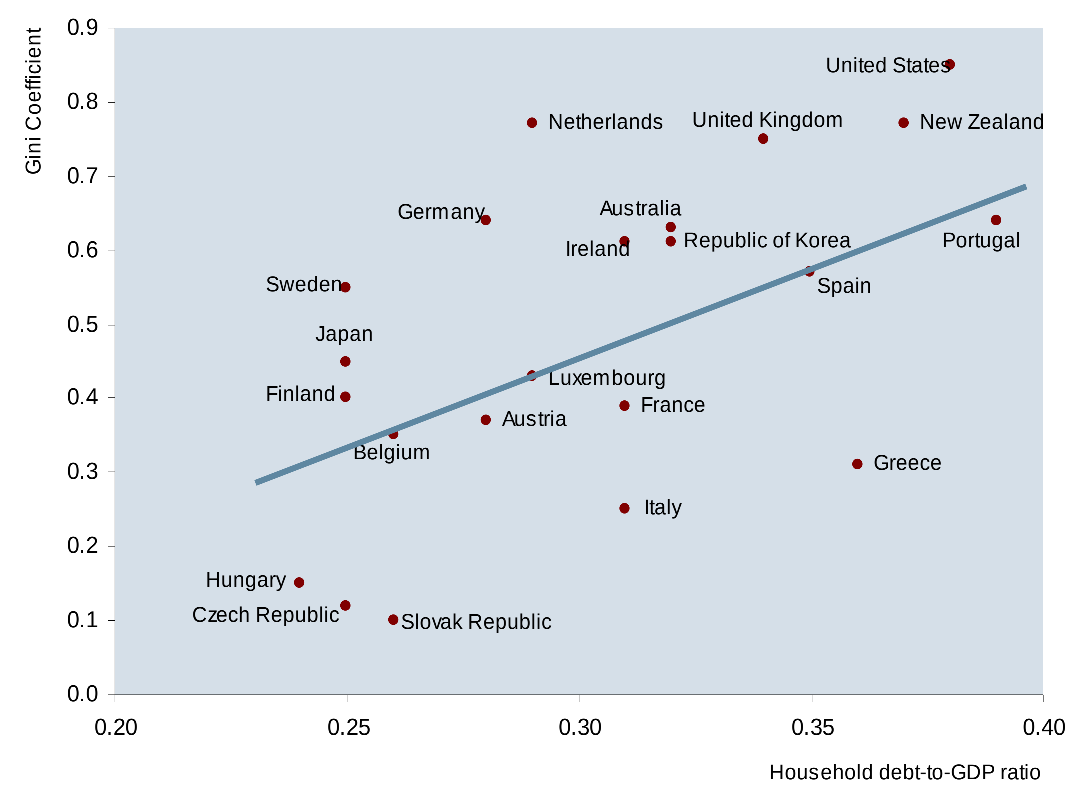
[82] For a recent analysis of executive pay, see F. Ebert, R. Torres, and K. Papadakis: *Executive Pay: trends and policy issues*, International Institute for Labour Studies, Discussion Paper No. 190, ILO, Geneva, 2008.
[83] Available at http://ec.europa.eu/ireland/press_office/news_of_the_day/pdf_files/global_report_-_final.pdf
[84] ILO: *The promotion of sustainable enterprises*, Report VI, International Labour Conference, 96th Session, Geneva, 2007.

corporate self-determination. The ILO's Social Finance Programme, supported by analytical work[85], provides a major benchmark in this respect.

Promoting social sustainability of economic growth…

148. One of the most significant challenges will be to ensure a more equitable distribution of the gains from globalization, as highlighted in the Social Justice Declaration. This is important in and of its own. In addition, as noted in the first section of this paper, excessive inequalities are a key factor behind the financial crisis. Among advanced economies, high income inequalities tend go hand-in-hand with a greater burden of household debt (Figure 13).

Figure 13. Household debt and income inequality in some OECD countries, 2005



Source: Estimates based on OECD data.

149. Moving forward, this means ensuring that tax policies are more progressive than hitherto – which requires international coordination so as to avoid harmful tax competition to attract high-income groups and businesses. Social protection reforms, as discussed in the third section of this paper, can be designed in such a way that they serve both equity and efficiency purposes.[86] Also, countries that have stronger tripartite

[85] See for instance B. Balkenhol: "Access to finance: the place of risk sharing mechanisms", in *Savings and Development* No.1, vol. XXXI, 2007, pp.69 - 90.
[86] ILO: *World of Work Report 2008. Income Inequalities in the Age of Financial Globalization*, International Institute for Labour Studies, Geneva, 2008.

institutions are better placed to ensure that the gains from globalization are distributed in a balanced manner. Finally, rising non-standard and informal employment – which tend to pay less than formal standard jobs – have contributed to rising income inequalities in developed and developing countries alike. More attention is therefore needed to the quality of employment created.

150. Financial globalization too, has reinforced the downward trend in the share of income going to labour and more fundamentally, has intensified economic instability. A new financial architecture, along the lines discussed above, must consider these social consequences in order to produce more stable and equitable employment and economic growth.

…as well as environmental sustainability

151. Globally, increased emphasis has been placed on investing in energy efficient technology for greener and more sustainable growth, and several governments have announced stimulus programmes designed to make progress in that regard (see Box 11). In some cases, the bulk of "greener" jobs created is likely, at least initially, to be in traditional sectors such as construction. Nevertheless, green investments should be viewed as an important step towards revitalizing the economy and generating more environmentally-friendly, decent work. And, in the medium to longer term, such investments can put countries on a path toward greener and more sustainable growth.

Box. 11 Green investments and job creation as a response to the crisis: some examples

Japan: To strengthen growth potential and move to a low-carbon society, the government plans to invest 100 trillion yen in green projects by 2015 which would create more than 2 million jobs in environmental businesses. The "green" initiatives include: accelerating the introduction of energy-saving and new energy technologies; subsidies for the development of the next generation high-speed railway; tax incentives for investments in energy-saving and new-energy facilities and equipment; and greater resources for research and development on cutting-edge environment technologies, including carbon dioxide capture and storage.

Republic of Korea: The government recently announced new investments in the order of $38 billion for a series of "green" initiatives to be rolled out over 2009-2012. This "Green New Deal" provides for nine core projects and 27 subsidiary projects in areas such as the restoration of major rivers, renewable energy, energy conservation, green transportation, clean water, recycling, and carbon reduction. These projects are expected to create as many as 960,000 new green jobs.

United States: The *American Recovery and Reinvestment Act*, signed by the President of the United States on 17 February 2009, includes significant investments in clean energy programmes. $5 billion is allocated for programmes to help low-income households weatherize their homes, which is expected to create about 375,000 jobs. Grants for energy efficiency in residential and commercial buildings amount to over $6 billion. These may create more than a million jobs, particularly in the construction sector, which has been hard hit by the recession.[87] $500 million is allocated to help workers train for "green jobs", while $11 billion is allocated for "smart grid" investments, $3.4 billion for carbon capture and sequestration demonstration projects, and $2 billion for research into batteries for electric cars.

[87] D.J. Weiss, A. Kougentakis: *Recovery Plan Captures the Energy Opportunity*, Center for American Progress, 13 February 2009.

Addressing the development dimension…

152. Even before the onset of the current financial crisis, significant food, education, health, social and environmental challenges existed for many developing countries. And the crisis is likely to aggravate the situation.

…by building capacity, notably administrative and institutional in developing countries…

153. As outlined in the third section of this paper, the ILO has developed expertise to help promote development through decent-work-friendly policies. The following are important policy elements of the global jobs pact: the implementation of job-rich infrastructure and housing projects, the fight against child labour and in favour of schooling, the build-up of social protection systems as fiscal conditions permit, and the enlargement of the fiscal space through well-designed policies that facilitate transition to the formal economy. In this context it is to be kept in mind that respect for core labour standards is not only a key social goal, but also creates the conditions for balanced economic development, itself conducive to greater prosperity in the long-run.

154. It is crucial to build up administrative and institutional capacity to make these programmes effective and to engage social dialogue as part of the strategy. The recent Mexican anti-crisis reform ("*Acuerdo nacional en favor de la economía familiar y el empleo*") provides an interesting example of what can be done.

… and creating a global jobs fund

155. Some countries are better-positioned than others. For example, those which took steps to better manage their economies and avoid excessive risk-taking and leverage are likely to be impacted less. Others are confronted with an array of challenges including limited fiscal space, a fragile current account, and potential runs on their currency. Indeed, countries inheriting large fiscal and current account deficits will be much more vulnerable, especially if these imbalances are driven by exogenous circumstances (most notably the need to cope with the terms of trade shock unleashed by the food and fuel price crisis of mid-2008).

156. Circumscribing policy options of particular developing countries with a framework of conditionalities by international financial institutions will compound the difficulties faced by such countries (see Box 8).[88]

157. What is needed is a counter-cyclical global mechanism, as advocated by some analysts.[89] For instance, a global jobs fund would provide support to countries facing the global crisis. It would rely on a line of credit separate from that of the traditional IMF package. And it would provide the necessary stabilization credit needed to sustain the

[88] More details on these issues will be provided in a forthcoming ILO publication by Employment Sector specialist.
[89] See for instance UNDESA: *Massive, globally coordinated fiscal stimulus is needed: going from the drawing board to swift action,* Policy Brief No. 11, January 2009. Also, the World Bank has called for the creation of a fund to help vulnerable countries.

external crisis without aggravating social hardship. Indeed the credit would not be subject to the condition that social protection and minimum wages be cut. Instead, it would be used to help revitalize the economy through investments that strengthen development prospects. Importantly, the measures would be adopted as part of national dialogue, so as to improve social cohesion. Involvement of the ILO, side by side with IMF and World Bank, would be crucial. Indeed, as shown in the third section of this paper, ILO has the expertise to design programmes that help create decent work and sustainable enterprises.

158. The President of the UN General Assembly has established the Commission of Experts on Reforms of the International Monetary and Financial System (the so-called Stiglitz Commission) to draw attention to the asymmetries in the capacities of developed and developing nations to respond to the crisis, among a range of other important issues. Through its position in the UN system, the ILO can support the Commission's work by pointing to the employment and social consequences of existing and proposed solutions to crises in developing countries.

Box 12. Macroeconomic stabilization in the wake of financial/economic crisis

Pakistan: In November 2008 Pakistan entered a stand-by arrangement with the IMF for a $7.6 billion adjustment programme to cope with its rising fiscal and current account deficits and price inflation. The adjustment programme calls for a reduction of the fiscal deficit to 4.2 per cent in 2008-09, and to 3.3 per cent during 2009-10, and an interest rate hike of 200 basis points to 15 per cent. These measures would inevitably dampen aggregate demand and the government has already lowered its growth rate forecast from 5.8 per cent achieved in 2007-08 to 4.4 per cent in 2008-09, with official admissions of worsening of unemployment and poverty. They would also run counter to policies advocated in international *fora* to stimulate the global economy. Indeed, the above *pro-cyclical* measures are likely to dampen global demand even further, and exacerbate poverty and unemployment in both Pakistan and its trading partners.

Ukraine: Between 2000 and mid 2008 Ukraine's economy was buoyant, with average annual growth in excess of 7 per cent. The fiscal position of the country was generally sound and the level of public foreign debt was moderate. However, in November 2008 the country signed a standby agreement with the IMF for $16.4 billion. This move came as a result of Ukraine's faltering economy in the second half of 2008 when commodity prices declined sharply, export markets contracted, and a large bank was placed under receivership – events which sparked massive capital outflows, a crisis on the foreign exchange market, significant currency devaluation, a major credit crunch in the real economy, and a massive increase in unemployment.

The recapitalisation of commercial banks is a high priority in the standby agreement with the IMF, but this is an extremely expensive undertaking. It is estimated that bank recapitalisation will cost at least 8 per cent of GDP, including 4.5 per cent of GDP for recapitalisation of foreign-owned banks. Given that a significant proportion of the recapitalisation costs will be borne by the government, at a time when tax revenues are declining dramatically, the government is required to significantly reduce other areas of public expenditure to produce a balanced budget in 2009 (as per IMF provisions).

Much of the fiscal tightening is expected to come through reduced expenditure on public sector wages and benefits, reductions in the overall level of social expenditure, revised indexation arrangements for social transfers, and a postponement of a planned increased in the minimum wage. These reforms imply a significant decline in the real value of pensions and other transfer payments, and a fall in real minimum wages. While it is important to restore the flow of credit to viable enterprises, the costly recapitalisation of the banks raises concerns, particularly when the opportunity cost is a substantial reduction in public expenditure on social security.

Source: Planning Commission: *Economic Stabilization with a Human Face,* Report of the Panel of Economists, GOP, October 2008; Z.M. Nasir: *National Policy Responses to the Financial and Economic Crisis*, 2009 (mimeo), (Pakistan); R. Kyloh and C. Saget: *A common crisis but contradictory responses: The European experience 2008/09*, (Ukraine), ILO Policy Integration Department, forthcoming 2009.

In sum, a global jobs pact with decent work principles at the fore can pave the way for a more sustainable economy in the longer term

159. It is imperative that responses to the crisis should not just be seen as piecemeal measures to be rolled out temporarily, only to revert back to "business as usual" as soon as possible. The challenge now is to respond to the current crisis through measures, which, as discussed above, pave the way for a better pattern of growth and development. Global coordination efforts currently underway could increase the propensity for multilateralism to tackle development challenges more creatively and effectively in the future.

160. In this way, international partners can contribute to a better global economy and society, which, together with a new financial system, can form the foundation for more sustainable development. In this respect, the ILO has an important role to play within the multilateral system, in cooperation with its partners at the national level, to advance opportunities for women and men around the globe to live and work in conditions of freedom, equity, security and dignity.

The Implications of the Global Financial Crisis for Low-Income Countries

I N T E R N A T I O N A L   M O N E T A R Y   F U N D

The Implications of the Global Financial Crisis for Low-Income Countries

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Preface

This paper was prepared by a staff team including Patricia Alonso Gamo, Udaibir Das, Thomas Helbling, Rolando Ossowski, Kate Langdon, Jan Kees Martijn, Stefania Fabrizio, Shamsuddin Tareq, Mary Zephirin, Julie Kozack, Paul Jenkins, Paulo Drummond, Paolo Dudine, Pritha Mitra, Aurelie Martin, Felipe Zanna, Samar Maziad, Alejandro Hajdenberg, Abdoul Aziz Wane, Ding Ding, Peter Kunzel, Bozena Elzbieta Radzewicz-Bak, Vahram Stepanyan, Barbara Dabrowska, Aminata Toure, and Maria Coelho.

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Executive Summary

The global financial crisis is expected to have a major impact on low-income countries (LICs), especially in sub-Saharan Africa—and urgent action is required by LIC policymakers and the international community. The crisis is projected to increase the financing needs of LICs by at least US$25 billion in 2009, and much larger needs are possible. Twenty-six LICs appear particularly vulnerable to the unfolding crisis. Additional external assistance and foreign financing will be essential to mitigate the impact of the crisis on LICs. The Fund is deploying its own financing facilities for LICs, while making efforts to sustain and catalyze additional assistance from other institutions and donors. Fund financing to LICs has already increased significantly; new financing arrangements jumped from 5 in 2007 to 23 in 2008, representing an increase in total (GRA and PRGF/ESF) disbursements from US$0.6 billion to US$5.4 billion. The Fund has also launched a broad examination of its LIC facilities and financing framework to ensure its financial assistance meets the diverse needs of its low-income members.

The global economy is in the midst of a deep downturn, affecting the real and financial sectors, that is taking its toll both in advanced and in emerging and developing countries. All major advanced economies are in recession, while activity in emerging and developing economies is slowing abruptly.

LICs are exposed to the current global downturn more than in previous episodes, as they are more integrated than before with the world economy through trade, FDI, and remittances. The crisis significantly impacts these countries through reduced demand for their exports. Since many are commodity exporters, they will be hard hit by the sharp decline in demand for commodities and in their prices. Many LICs are also hit by lower remittances and foreign direct investment (FDI) while aid flows are under threat. Growth of remittances was flat in the second half of 2008, and is expected to be negative in 2009. A sharp slowdown in FDI is expected in about half of all LICs. Prospects for higher aid to offset these effects are particularly uncertain, given budgetary pressures faced by many donor countries.

LICs' financial systems have so far not been strongly affected by the global crisis. Their banks have little, if any, exposure to complex financial instruments. However, those LICs that had begun to access international financial markets have seen this access come virtually to an end. Foreign lenders may become more reluctant or unable to roll over sovereign and private debt falling due. Domestic banks may be hit by second-round effects, as the economic downturn increases the number of borrowers unable to repay their loans.

The global financial crisis will worsen the budgetary position of many LIC governments. Government revenues are expected to suffer as economic activity slows and commodity prices fall. Potential declines in donor support and tighter financing conditions will likely impose further pressures on LICs' budgets. At the same time, many countries will need to increase spending to protect the poor, and additional spending pressures may arise from currency depreciation and rising interest rates, which could raise debt service costs.

There is a risk that the impact on LICs could be more serious—26 countries appear particularly vulnerable to the unfolding crisis. These include countries heavily dependent on commodity exports, such as oil exporters, as well as fragile states with little room for maneuver. Baseline projections for 2009 foresee a total balance of payments shock of US$165 billion. They also suggest that LICs may need at least US$25 billion to offset the impact of the shock on their international reserves; given the heavy downside risks to the forecast, the needs could be much larger—approaching US$140 billion in a "bad case" scenario.

Countries in initially strong budget positions may have some scope to accommodate the cyclical fiscal deterioration and, in some cases, to increase spending to cushion the impact of the crisis. These are countries without public debt sustainability and financing constraints that have achieved macroeconomic stability. Commodity producers that built up financial cushions during the boom may be able to maintain spending or adjust gradually.

In many LICs, however, the ability to offset adverse shocks through spending hinges on higher donor support. With many countries facing binding fiscal constraints, and the outlook for significantly increased bilateral aid flows unlikely, many countries will need to rationalize spending and increase its efficiency to create fiscal space for protecting social and MDG-related spending. Efforts will also be required to strengthen revenue mobilization.

Given the economic downturn, efforts to strengthen safety net programs to protect the poor become more urgent. Transfer programs that effectively target the poorest often result in a larger stimulus to aggregate demand, given their higher propensity to consume. The capacity of many LICs to put in place new targeted programs will be limited in the near term. There may be scope, however, to scale up existing spending programs in targeted ways. For example, countries can implement public works programs and/or provide income supplements through existing programs. Additional resources can be channeled to targeted programs, such as targeted food distribution or school meal programs.

Countries should focus on macroeconomic stability. In some countries with falling inflation there may be scope for monetary easing; others, however, still experience continued or renewed price pressures. Those with flexible exchange rates should allow them to move, so that they function as shock absorbers. Fixed exchange rate regimes may come under particular pressure owing to the adverse direct impact of the crisis. Steps are also needed to prevent the global financial crisis from spreading to their domestic financial sectors.

The Fund is assisting members in their crisis planning and response efforts and will continue to adapt its financial toolkit and policies to better serve its low-income members. The Fund will provide financial support to LICs that responds to their economic circumstances, the nature of the balance of payments problem, and their existing program relationship, if any, with the Fund. LICs' demand for Fund financing has already increased in 2008 and will likely increase further, as will technical assistance needs.

I. Introduction

The global financial crisis has spread rapidly since the fall of 2008, leading to a global downturn of uncertain severity and duration. The impact of financial sector turmoil on real activity has become increasingly evident, propagating beyond its initial epicenters to affect other advanced economies, emerging markets, and LICs.

This paper analyzes the impact of the global financial crisis on LICs.[1] It provides an overview of the possible impact of the crisis on the short-term macroeconomic outlook. To assess the magnitude of the effects, the paper compares current (January 2009) projections with those made before the crisis. In addition, simulations illustrate the heavy downside risks to these projections.

While for many LICs the effects of the crisis have lagged the rest of the world, its eventual impact may be severe, especially given their often limited scope for countercyclical policies. Many LICs have made great strides in strengthening their policy frameworks and robustness to shocks, reducing poverty, and reforming their financial systems. But many remain highly vulnerable to a deep global downturn that so closely follows the 2007/08 food and fuel price shocks. Financial market linkages are generally weak, but second-round effects of the economic slowdown on the financial system could be particularly severe. Without additional aid, the scope for countercyclical policies is limited for most LICs due to binding financing constraints and fragile debt positions. This could both deepen and prolong the crisis in LICs, and set back the fight against poverty.

Against this background, the paper provides policy advice on how best to address the impact of the crisis on LICs and describes the Fund support. The Fund assists countries in designing policies to support growth and mitigate risks to the financial system. The Fund is also deploying its own financing facilities for LICs, while making efforts to sustain and catalyze additional assistance from other institutions and donors.

The paper is structured as follows. Section II discusses the outlook for global economic growth and commodity prices, while Section III provides an overview of the changes in economic projections associated with the crisis. The various financial channels and spillovers from the global downturn are discussed in Section IV. Section V analyzes the fiscal and debt sustainability implications of the crisis. Country vulnerabilities are investigated in Section VI. Policy recommendations to help countries weather the crisis are considered in Section VII, with LICs' potential additional financing needs assessed in Section VIII. Finally, Section IX concludes with a review of ways in which the Fund can assist its LIC membership.

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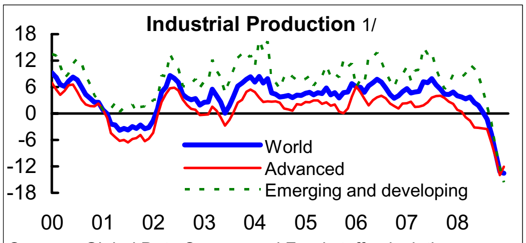
[1] Generally, references to LICs in Fund documents relate to all 78 PRGF-eligible countries. However, because of data limitations, and unless indicated otherwise, data for LICs reported in this paper refer to the more limited set of 71 countries listed in Appendix I.

II. Outlook for Global Growth and Commodity Prices

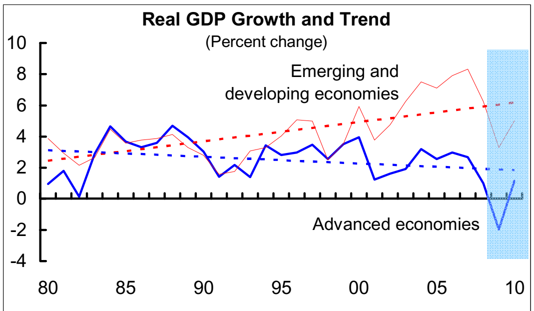
The global economy is in the midst of a deep downturn as an adverse feedback loop between the real and financial sectors is taking its toll both in advanced and in emerging and developing countries. As a result, commodity prices are unlikely to recover in the short run.

All major advanced economies are in recession, while activity in emerging and developing economies is slowing abruptly. Continued deleveraging by the financial sector and dramatic declines in consumer and business confidence have triggered a sharp deceleration in domestic demand across the globe. World trade and industrial activity are falling sharply, while labor markets are weakening at a rapid pace, particularly in the United States. The decline in commodity prices is providing some support to commodity importers, but is weighing heavily on growth in commodity exporters.



Sources: Global Data Source; and Fund staff calculations.
1/ Annualized percent change of 3-month moving average over previous 3-month average.

Global growth is set to weaken considerably. Activity is expected to decelerate from 3½ percent in 2008 to ½ percent in 2009 before embarking on a gradual recovery in 2010.[2]



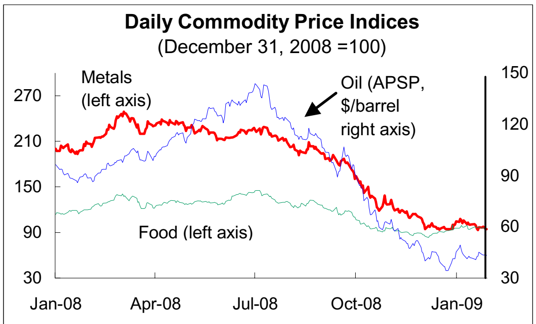
Source: Fund staff calculations.

The advanced economies as a group are facing their sharpest post-war contraction. The euro area and Japan have been hard hit by the decline in external demand, while uncertainty about the course of the economy is dampening consumption and business investment in the United States. Activity in these countries is now expected to contract by 2 percent in 2009, followed by a modest rebound in 2010.

Growth in emerging and developing economies is also slowing sharply. Financing constraints, lower commodity prices, weak external demand, and associated spillovers to domestic demand are expected to weigh on activity. As a result, growth is projected at 3¼ percent in 2009—a markdown of 3¼ percentage points compared with the April 2008 WEO and less than half the pace in 2007—before rebounding to around 5 percent in 2010.

[2]In line with WEO conventions, data reported in this section are country averages weighted by GDP valued at PPPs, and may differ from averages mentioned in other parts of the paper.

- Countries in central and eastern Europe and the Commonwealth of Independent States have been hit particularly hard by capital flow reversals and, in some countries, falling commodity prices. Activity is expected to contract by ½ percent in 2009.



Sources: Bloomberg, and Fund staff calculations.

- Commodity exporters, particularly in Latin America, Africa, and the Middle East, face a sharp decline in commodity prices, putting pressure on external accounts and government finances. In Latin America, growth is also constrained by weaker external demand (notably from the United States) and tighter financial conditions, and is expected to slow from 4½ percent in 2008 to 1 percent in 2009.

- For countries in emerging Asia—including China—terms of trade improvements from falling commodity prices and macroeconomic policy easing will not prevent a significant slowdown as export demand weakens and investment is cut back. Overall, growth in this region would decline from 7¾ percent in 2008 to 5½ percent in 2009.

With growth well below trend in emerging and developing economies, commodity prices have collapsed over the past few months. Expectations of resilience in these economics had underpinned commodity prices for much of 2008, but hopes for "decoupling" have since evaporated. Commodity prices tend to be significantly cyclical, as output contraction in commodity-intensive sectors exceeds that in other sectors.

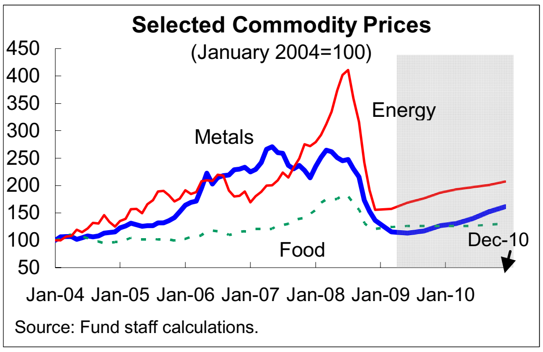
Financial turmoil and U.S. dollar appreciation have exacerbated the downward price momentum. Investors have sought to reduce their holdings of commodity assets, given increasing concerns about counterparty risks (many standard commodity investment instruments such as total return swaps involve such risks), decreasing availability of credit for leveraged commodity market exposure (e.g., by hedge funds), a rising preference for liquidity, and sizable recent appreciation of the U.S. dollar in nominal effective terms.

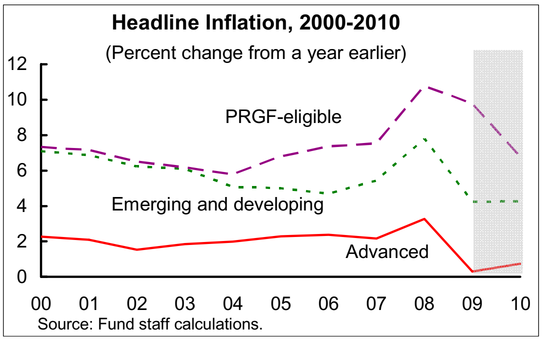
Commodity prices are unlikely to recover while global activity is slowing.

- OPEC production cuts could eventually help to support oil prices if implemented close to target, as scope for increased production elsewhere seems limited. Nevertheless, still softening demand and rising inventories will continue to weigh on the market in the short term.

- Near-term metals price prospects depend on construction and investment demand in key emerging and developing economies.

- Food prices are likely to be less affected by the slowdown since food demand is less income-elastic than other commodities. Lower prices for energy inputs will likely lead to some further easing of prices, although the high fuel and fertilizer prices through mid-2008 may weigh on supply in 2009.





Lower commodity prices and increasing economic slack will help to contain inflation pressures. In the advanced economies, headline inflation should decline to below ¼ percent by the end of 2009, and deflation risks are becoming an increasing concern in some countries. In emerging and developing economies inflation is also expected to moderate.

III. How Are LICs Affected? An Overview

The global financial crisis is expected to have a severe impact on growth and external stability in many LICs. At the same time, inflationary pressures are receding in most countries. The crisis follows the commodity price shocks of 2007–08, putting at risk an extended period of improved macroeconomic policies and performance through mid-2007 (See Box 1).

Going into the global financial crisis, the balance of payments of many LICs had already been severely weakened by the 2007–08 spike in global fuel and food prices. Between January 2007 and July 2008, LICs faced a food price shock, which peaked in mid-2008, of almost 1 percent of GDP, and a fuel price shock averaging almost 3½ percent of GDP. As a result, some 33 out of a group of 78 LICs were identified as particularly vulnerable, with reserve cover falling below 3 months of imports.[3]

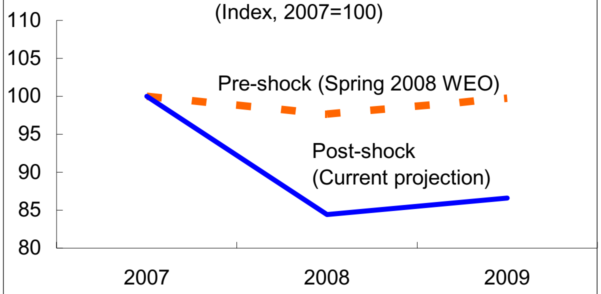
[3]IMF (2008a).

The current crisis is expected to have serious adverse effects on LICs, albeit with a lag relative to the impact on more advanced economies. To date, many LICs have seemed fairly resilient to financial crisis, reflecting the still limited nature of cross-border linkages in their banking systems. However, the picture is expected to worsen as the lagged effects on real activity around the world feed through to LICs. In this context, the fact that domestic rather than export-driven agriculture accounts for a large share of the economy in many countries (particularly in Africa) might help attenuate somewhat the impact of the crisis.

The emerging macroeconomic pressures are evident from the sharp changes in the economic projections for 2009 (Figure 1, and Appendix II). These revisions—which remain subject to much uncertainty, with risks mainly on the downside—reflect both direct financial effects of the crisis and the repercussions of global economic downturn.

- Growth projections for 2009 have been revised down since the spring of 2008, from 6.4 percent to 4.3 percent, on average.
- Trade balance and current account projections are shaped by the collapse of commodity prices, and the anticipated adverse effects of the crisis on LIC exports and remittance inflows. While the net effect could be benign for some net food and fuel importers, the impact is decidedly negative for commodity exporters.
- Financial inflows are subject to large downside risks. For many LICs, current projections show a clear adverse effect of the crisis on inflows of foreign financial and direct investment, and on aid.
- Reflecting the above, projected reserves accumulation by LICs in 2009 has declined significantly since the April 2008 WEO, with reserves now projected to fall from 4.4 to 4.2 months of imports in 2009, on average, compared with previous projections of an increase of 0.3 month.

LIC Reserves in Months of Imports
(Index, 2007=100)

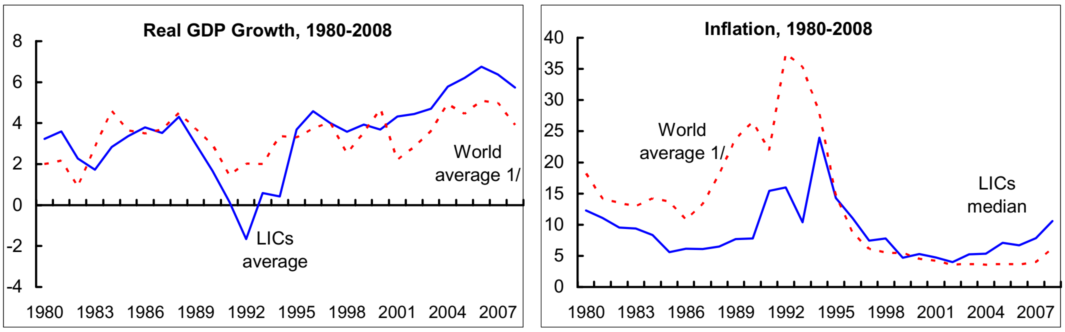


Sources: WEO database; and Fund staff calculations.

- Inflation is expected to drop sharply in 2009 from the peaks seen in 2008. Following the food and fuel price shocks, inflation spiked upwards in 2008, rising in many LICs to more than 20 percent. With the recent declines in food and fuel prices, these initial pressures are receding. Falling demand in the wake of the global crisis will help lower inflation further. The latest projections show median inflation declining from 11¼ percent in 2008 to 7¾ percent in 2009—which remains above earlier projections.

Box 1. The Pre-Crisis Recovery

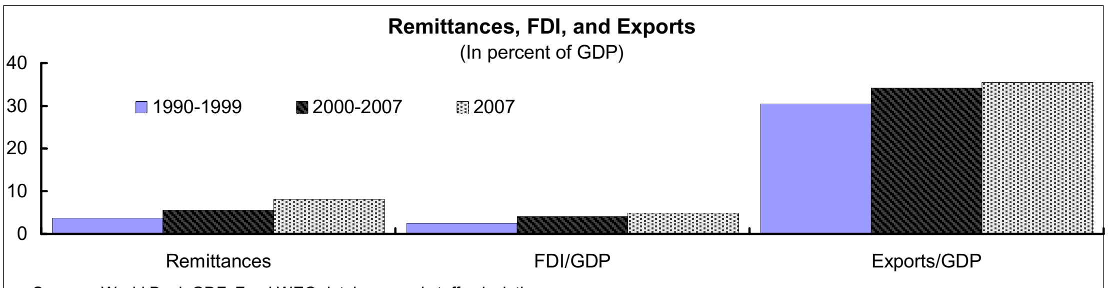
In many LICs, the years leading up to 2007 witnessed a strong recovery in growth, while long-standing challenges of high inflation and high debt were also successfully tackled. Fiscal and current account deficits were put on a downward path (except to reflect the spending of stepped up aid), and international reserves were raised to their highest level in decades (Appendix II, Figure 1). All of this was accomplished, in varying degrees, through a combination of better macroeconomic policies, higher aid, debt relief, and the support of more conducive global economic conditions (including better terms of trade).



Sources: WEO database, and Fund staff calculations.
1. Emerging and developing countries.

The improvement in macroeconomic conditions was fairly broad-based, but particularly strong for African countries, debt relief recipients, and (more recently) net oil exporters. African countries saw their growth rates almost double between the 1990s and the 2000-07 period (Appendix II, Figure 2). In recent years, net oil exporters saw sharp improvements in macroeconomic conditions alongside large terms of trade gains.

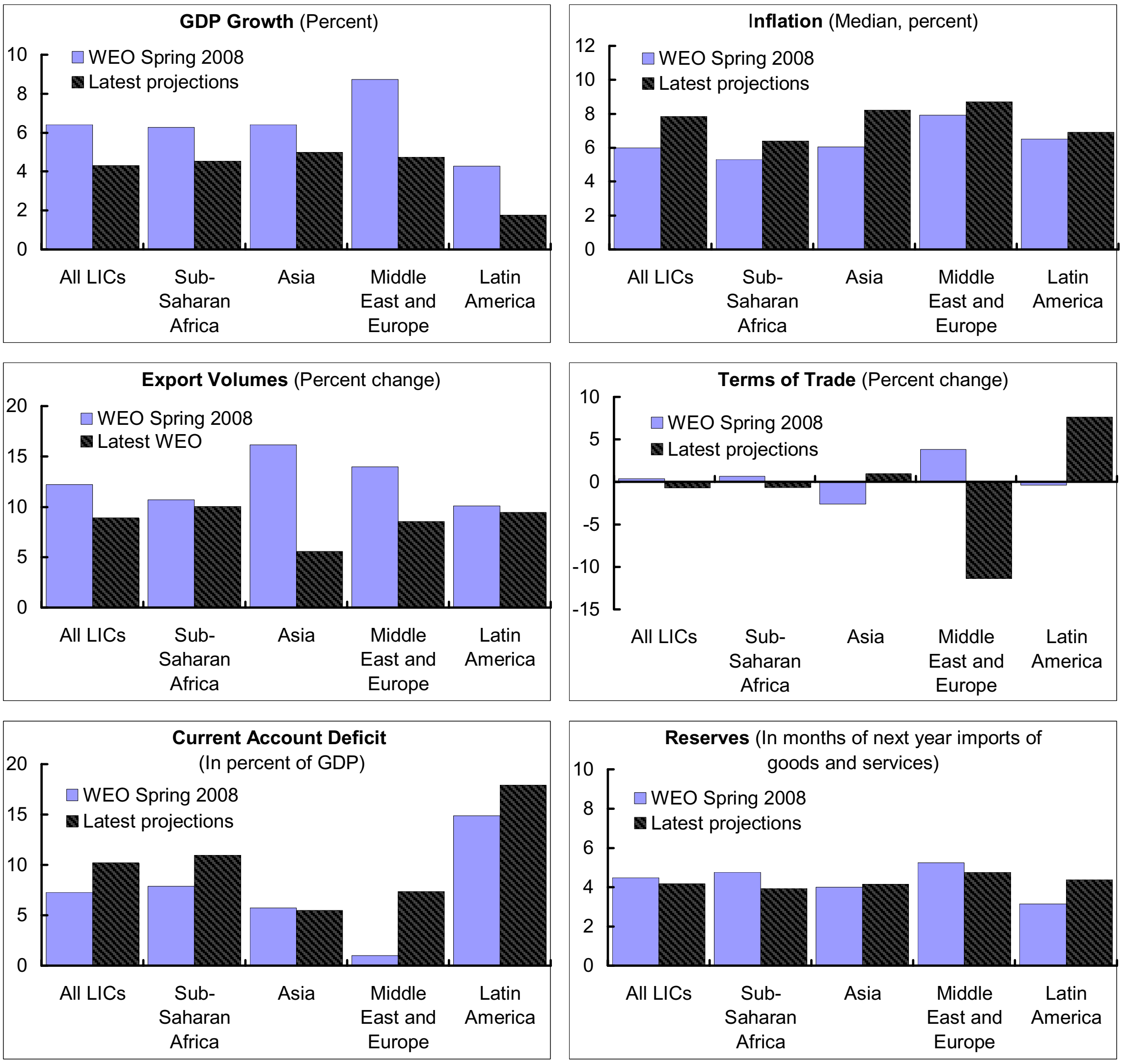
However, the increased openness that has contributed to the improved performance has also increased exposure to external shocks. The accumulated macroeconomic gains will assist LICs in withstanding economic shocks: higher reserves permit countries to address temporary financing shortfalls, while lower initial deficits and debt create fiscal space for countercyclical policy. At the same time, increased trade and financial links with the outside world also imply greater dependence on external conditions: exports now amount to more than a third of GDP in LICs (from just 10 percent in 1990); FDI is close to 5 percent of GDP, a roughly five-fold increase from 1990; and several LICs have gained access to financing on international markets (see Section IV).



Sources: World Bank GDF, Fund WEO database, and staff calculations.

Figure 1. The Changed Outlook for 2009

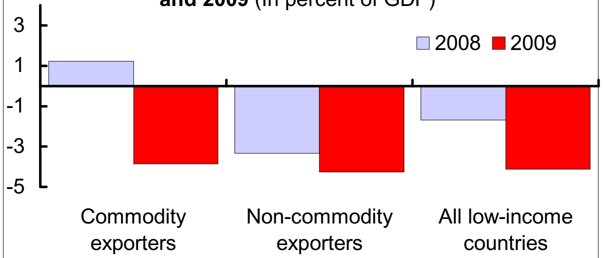
(Period averages, in percent, unless otherwise indicated)



Sources: WEO database, and Fund staff calculations.

The overall fiscal balances of LICs are projected to deteriorate on average by about 2½ percentage points of GDP in 2009. The outlook varies substantially across countries. Commodity exporters are expected to experience some of the largest negative shifts in fiscal positions—by 5

Average Overall Fiscal Balance by Country Groups 1/, **2008 and 2009** (In percent of GDP)



1/ Including grants.
Source: Fund staff calculations.

percentage points of GDP, on average—due to significant revenue declines.[4] The balances of non-commodity exporters are expected to deteriorate on average by close to 1 percentage point of GDP, mainly due to their maintaining spending in the face of lower growth and revenues.[5]

The global financial crisis could—in principle—lead to large exchange rate adjustments in LICs, but a number of attenuating factors may work to limit prospective depreciations. First, almost two-thirds of LICs have fixed exchange rate regimes (including countries with de facto pegs), shifting the burden of external adjustment onto fiscal and monetary policies. Second, import demand will tend to drop, not only as a result of slower growth but also because some declining inflows (such as FDI) have a heavy import "content." And, third, import bills will shrink as a result of lower food and fuel prices.

IV. The Impact of the Crisis: The Channels

The direct impact of the global financial crisis on LICs will be stronger for countries with a higher degree of financial integration. For most, this channel has played a limited role so far, though strains are starting to appear. But, the slowdown in global growth will reduce trade, remittances, foreign direct investment, and, possibly, aid, and these factors will have a major impact on LICs, including second-round effects on the financial sector.

Direct Financial Channels

Structures and financial system conditions vary vastly across the LICs. Despite several initiatives for financial sector reform over the past decade, entry of foreign financial institutions, and the emergence of private external creditors and investors, the breadth, diversification, and competitiveness of LICs' financial systems remain shallow and distortionary. Most have small derivatives and interbank markets, low level of reliance on international capital, and regulatory barriers constraining new financial products and market entry by new institutions.

As a consequence, thus far, the direct financial transmission of the global crisis appears to have been relatively limited. However, emerging signs that the crisis is spreading to LICs are evident, in particular, for those that had begun to access international capital markets (for example, Ghana and Sri Lanka), or where direct and indirect foreign financing

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[4]Some oil producers like Angola, Azerbaijan, and the Republic of Congo may suffer less due to rising oil volumes.

[5]This result is similar to the average projected deterioration in the fiscal balance of non-commodity exporters that are faced with below-trend growth, when the elasticities are assumed to be one for revenues and zero for expenditures and automatic stabilizers are allowed to work.

in local markets was on the rise (Kenya, Nigeria, Malawi, Ghana, Uganda, and Zambia). The global downturn and ongoing stress in the international credit markets are curtailing private capital inflows in a number of LICs (e.g. Uganda and Zambia) and the operations of foreign banks in the local markets, creating funding pressures in banking systems.[6] LICs are experiencing outflows of capital, and there are initial pressures on foreign exchange markets and the yield curve. The financial crisis is also sharply reducing private sector credit, in part reflecting banks' need to increase liquidity buffers given expected cuts in external credit lines.

As the negative effects from a slowdown in the real sector gain ground, the pressures on financial systems are likely to rise. These second-round effects could affect the corporate sector, the balance sheets of banks, as well as the sovereign, placing further pressure on LICs' ability to manage the fallout of the crisis. As domestic economic conditions deteriorate, the financial condition of the banks may deteriorate rapidly, as borrowers' capacity to repay is impaired, and banks' funding bases shrink. Also, exchange rate depreciation could expose some bank borrowers to exchange rate risk, or raise their costs of operation, with negative effects on loan recovery performance.

Impact on Domestic Banks and Non-Bank Financial Institutions

To date, the direct impact on LICs' banking systems remains modest. The existence of capital controls in several countries and structural factors have helped to moderate both the direct and the indirect effects of the financial crisis:

- *Banking systems have little exposure, if any, to complex financial instruments.* This has resulted in fewer exposures and risks of potential losses;
- *Abundant low-cost domestic deposits and liquidity.* This has allowed banks to finance themselves with domestic funds and thereby minimize wholesale leverage on their balance sheet. Many banks are highly liquid and, owing to weak competition, have high profit margins contributing to a buildup in capital buffers.

That said, some erosion can be expected in the quality of banks' asset portfolios as well as in their financial performance. In a number of countries, the financial soundness indicators published in the third quarter of 2008 show some weakening of nonperforming loan (NPL) ratios, reversing past trends. Although, on average, banks' profits remain high, intensifying bank competition to retain deposits is likely to reduce interest spreads (Cambodia, Mongolia, and Pakistan).[7]

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[6]There is also evidence of portfolio inflow reversal and capital flight, even in countries with capital restrictions (e.g., Kenya, Tanzania, and Nigeria).

[7]Fitch Rating Reports (November 2008).

Table 1. Selected Financial Soundness Indicators in LICs

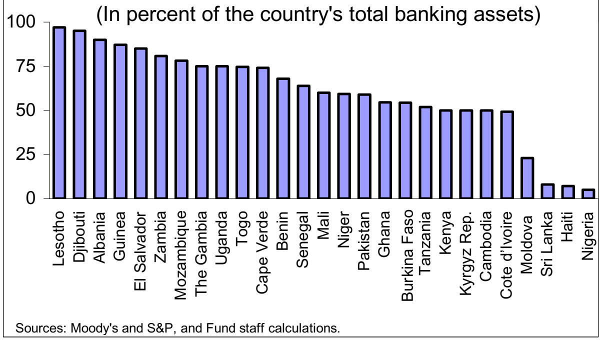
	CAR 1/		ROA 2/		ROE 3/		NPLs ratio 4/		Liquidity ratio 5/	
	2006	2008Q3	2006	2008Q3	2006	2008Q3	2006	2008Q3	2006	2008Q3
Armenia	34.9	27.2	3.6	2.9	15.9	13.1	2.5	3.9	51.5	35.1
Azerbaijan	18.7	17.7	1.3	2.2	9.9	18.7	6.6	2.3	…	…
Cambodia	26.5	25.6	2.8	3.1	14.2	15.8	9.9	2.7	41.7	38.6
Ghana	15.8	15.4	4.8	3.6	39.6	31.5	7.9	8.7	46.3	39.1
India	12.4	12.7	0.9	1.0	…	…	3.5	2.4	…	…
Kenya	10.6	11.2	2.8	3.2	28.6	33.7	15.0	8.1	30.5	38.6
Kyrgyz Republic	28.5	30.8	3.4	3.8	23.2	20.4	6.2	4.1	77.8	81.0
Lesotho	19.0	15.0	2.0	2.4	27.0	31.7	2.0	3.5	…	…
Moldova	27.9	30.8	3.4	4.1	20.5	23.3	4.4	4.6	33.5	31.4
Nigeria	22.6	22.0	1.6	2.4	10.4	13.9	8.8	6.1	32.5	31.0
Pakistan	12.7	13.4	2.1	2.0	23.8	20.6	6.9	7.4	31.9	34.0
Vietnam	6.6	7.4	1.5	1.5	…	…	2.6	2.5	14.4	14.0
Zambia	20.4	17.0	5.1	5.0	30.6	36.6	11.3	6.0	41.3	32.8

Sources: National authorities, and Fund staff calculations.
1/ Regulatory capital to risk - weighted assets.
2/ Return on average assets.
3/ Return on average equity.
4/ Non-performing loans to gross loans.
5/ Ratio of liquid assets to total assets.
Note: Due to differences in national accounting, taxation and supervisory regimes, FSI data are not strictly comparable across countries.

Furthermore, prolonged liquidity pressure in domestic financial markets is beginning to have an impact on several LICs' banking systems. Increasing interlinkages between banks and local capital markets as well as weaknesses in banks' risk management have begun to expose banks to market volatility, particularly in countries where high equity returns had encouraged borrowing for investing in the stock market (Nigeria and Kenya). At the same time, as banks' own share prices have fallen, their cost of capital has gone up, which will constrain their ability to grow.

Given the prevalence of foreign-owned banks, LICs may face difficulties from withdrawal of funds by their parent companies. Countries with licensed subsidiaries of foreign banks, rather than branches, may be better positioned to detect potential risks of capital withdrawal, as their local operators are subject to local supervision.[8]

Foreign Ownership in LICs' Banks, 2008Q2
(In percent of the country's total banking assets)



Sources: Moody's and S&P, and Fund staff calculations.

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[8]Among the typical channels through which such withdrawals take place are (i) subsidiaries asked to sell profitable loans in order to increase the capital-asset ratio on a consolidated basis; and (ii) shift in deposits from subsidiaries to headquarters. Where there is sufficient liquidity and foreign exchange availability, foreign banks have reduced their shareholding in foreign subsidiaries by selling to domestic investors.

Table 2. Deposit Money Banks' Exposure to Foreign Creditors in Selected LICs

	2006	2007	2008Q3	2006	2007	2008Q3
	(Millions of U.S. dollars)			(Percent of liquid foreign assets)		
Armenia	183.5	475.2	687.4	234.2	311.6	357.3
Azerbaijan	235.5	973.3	1,978.2	16.0	5.9	10.2
Chad	100.1	120.6	205.4	75.7	162.9	198.9
Honduras	609.4	749.9	775.5	…	…	…
Lesotho	10.5	10.8	5.5	…	…	…
Liberia	22.2	13.3	12.7	0.9	1.0	…
Madagascar	39.0	50.5	87.8	264.8	281.1	280.9
Mali	171.9	225.2	…	…	…	…
Niger	50.3	69.0	90.6	0.1	0.1	0.1
Sri Lanka	941.4	960.7	1,003.9	…	…	…

Sources : National authorities, and IMF staff estimates.

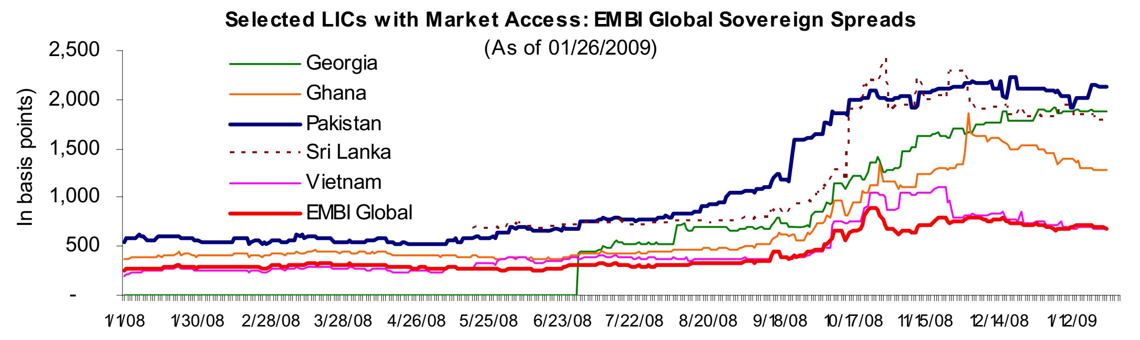
Banks relying on foreign funding sources may also be subject to possible rollover risk. Lower availability of foreign capital due to tighter global liquidity conditions may hamper the ability of some banks to roll over maturing foreign exchange obligations. This situation may be worsened by tighter domestic financing in some LICs. It has also become increasingly difficult for many microfinance institutions to find foreign sources of funds. Some previously available foreign credit lines are now being cancelled.[9]

Impact on Financial Markets

Access to International Markets and Costs of Financing

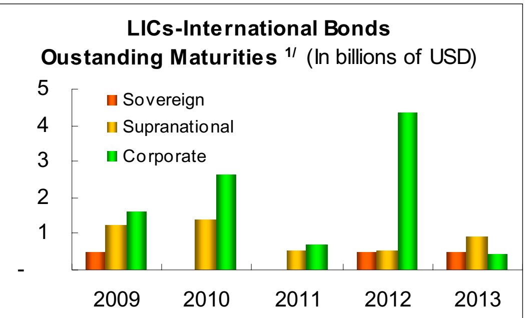
Access to market-based international financing was opening up to LICs with strong fundamentals, but it now appears to be closing. Sovereign spreads have increased dramatically for these countries, reflecting investor liquidity needs and flight to higher quality assets (i.e., U.S. treasury bills) rather than a negative credit outlook—LICs' sovereign credit ratings generally remained stable or even improved during the second half of 2008.

[9]There have been fears that the failure of banks with liquidity/solvency issues at home would require closure of subsidiaries in low-income countries. In most cases, however, guarantees by the parent country governments of foreign banks have allayed these fears. The risk of sudden liquidity withdrawal is also generally attenuated by the low reliance on these markets by parent banks, as from a global point of view the funds involved are small. In some cases, foreign banks may prefer to leave their local interests untouched for strategic reasons, such as long-term prospects of the economy. The presence of exchange or capital controls also tends to limit such withdrawals.

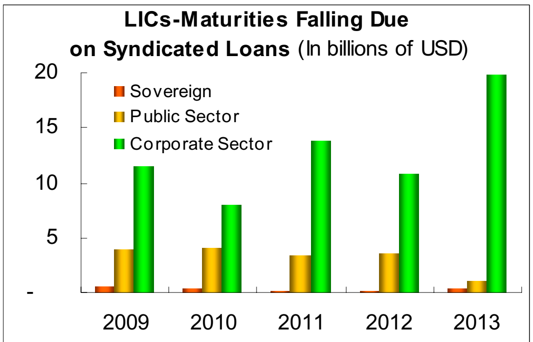


Source: Bloomberg.

Current market conditions have led several LICs to postpone their issuance plans (Albania, Kenya, Tanzania, Uganda, and Zambia), and roll-over and liquidity risks are rising (See Box 2).[10] This could also lead to an intensifying liquidity squeeze, in particular for the corporate sector which accounts for the bulk of the upcoming maturities. Thus, the potential for rollover risk is high, and LICs' capacity to meet financial obligations may be further affected by reduced domestic resources as the crisis impacts the real sector.

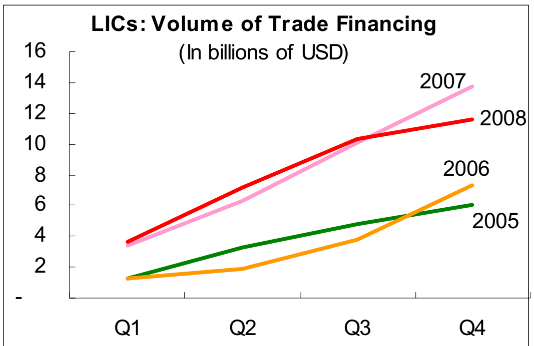


Source: Dealogic.
1/ Includes callable bonds.



Source: Dealogic.

As global liquidity conditions have tightened over the past few months, trade financing has been adversely affected. The financial crisis has constrained access to trade financing (e.g., Lesotho, Pakistan, and Sri Lanka) and put upward pressure on costs. LICs' volume of trade financing dropped by 18 percent in the last quarter of 2008.



Source: Dealogic Loan Analytics.

[10]For an in-depth review of recent debt management issues in LICs see also joint IMF–World Bank Board paper on "Managing Public Debt: Formulating Strategies and Strengthening Institutional Capacity" March 2009 (forthcoming).

Box 2. Private Capital Inflows to Local Currency Sovereign Debt Markets in LICs

Market participants indicate that nonresidents' exposure in local LIC markets is built not only through direct position taking, but also through offshore derivative contracts. In particular, nonresidents may engage in total return swaps with residents, which at an agreed future date will deliver the full return on the local LIC debt security to the nonresident in exchange for another income stream (often LIBOR plus a mark up). Given that the balance of payments does not necessarily record a capital flow related with such a transaction at the time of its ratification, policymakers face a large degree of uncertainty as to the magnitude of such exposures.

Risks associated with sizable nonresident investments in LIC local debt markets are, however, qualitatively different from those encountered in more developed markets. Several characteristics of LICs and their debt markets render these countries particularly vulnerable when private external creditors suddenly run for the exit, regardless of whether foreign investors reduce their exposure directly or through the unwinding of derivative contracts with domestic institutions: (i) domestic local-currency debt typically involves very short maturities reflecting factors such as a high susceptibility to exogenous shocks, the lack of a strong macroeconomic track record, and the absence of credible mechanisms to index the debt instruments to inflation or GDP growth; (ii) there tends to be a bunching of maturities due to an underdeveloped yield curve and weaknesses in debt management; (iii) investment risk often remains concentrated within the domestic banking sector due to the lack of a broader investor base; and (iv) the monitoring of investor sentiment may be complicated by the fact that the illiquidity of many financial markets delays the transmission of a confidence shock to asset prices.

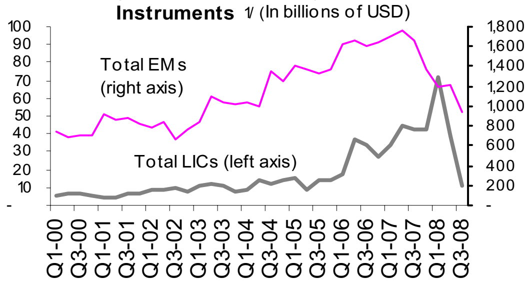
Over time, adverse balance sheet effects could affect the sovereign's solvency. As long as nonresidents remain invested in the country, the net loss of interest income for the central bank stemming from the large gap between interest rates on domestic sterilization bonds and those on its foreign assets would weaken the institution's profitability over time. When investor sentiment drops and nonresidents sell their exposure, a prolonged period of high interest rates combined with the realization of contingent liabilities emanating from the dynamics discussed below could turn a sovereign liquidity crisis into a solvency crisis.

The spread for some trade financing widened in November 2008 to 500 bp over LIBOR from 80 bp a year earlier.[11] In trade transactions, customers are seeking longer repayment periods, while banks are requesting more difficult terms and conditions.

Domestic Financial Markets

Domestic financing conditions are also tightening in some LICs. Domestic interest rates have increased considerably in a number of LICs. The EMTA survey reports that, between Q2 and Q3 of 2008, trades of local debt by foreign investors had dropped 71 percent in LICs, compared to only 22 percent for emerging market debt.

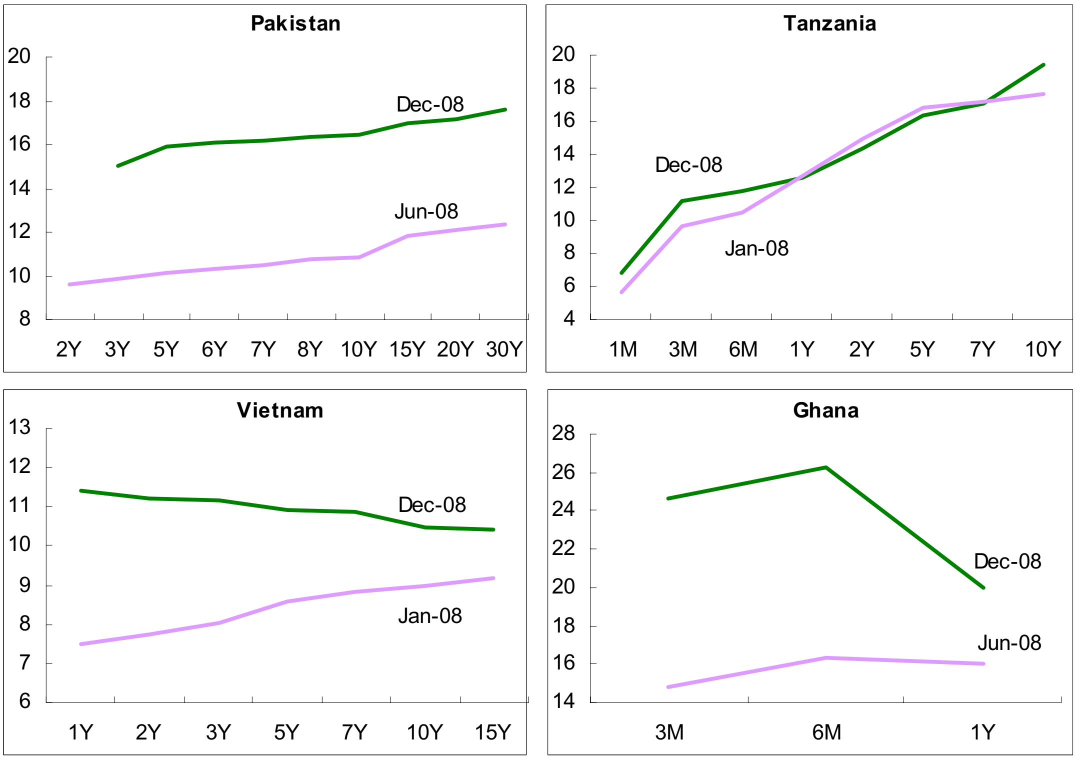
Foreign Investors Trading of Local Debt Instruments 1/ (In billions of USD)



Source: Emerging Markets Trading Association (EMTA).
1/ Both purchases and sales of assets in the secondary trading market.

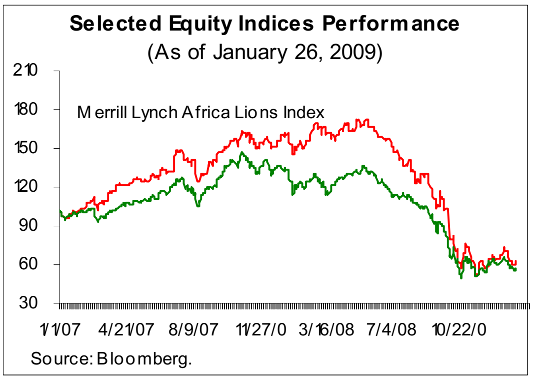
[11] HSBC Global Research (November 2008).

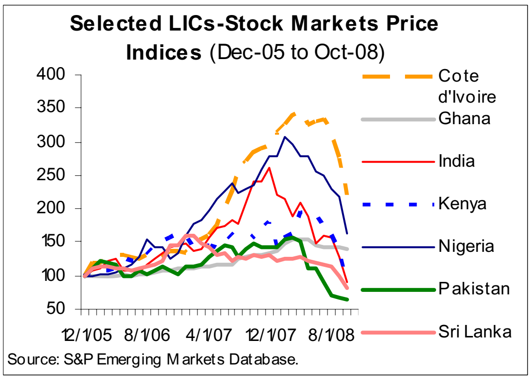
Selected LICs: Domestic Yield Curves



Source: Authorities' w ebsites.

Stock markets have similarly been impacted by the crisis. The Merrill Lynch Africa Lions Index, which tracks 15 African countries, declined by almost 70 percent during March–December 2008. Exchanges in other LICs have fallen considerably as well, reflecting a decline in corporate valuations, particularly in sectors that are vulnerable to the retrenchment in global economic conditions.[12]





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[12]These are typically export sectors. For instance, in the WAEMU region, recent stock market declines have particularly affected textiles, tourism, and agro-industrial sectors.

Spillovers from Global Recession

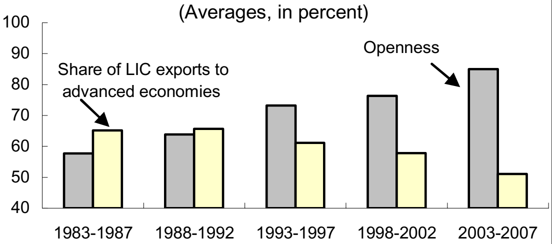
Reflecting their increased integration in the world economy, the global recession is expected to have a major impact on LICs (Boxes 3 and 4). LICs are heavily dependent on trade, which is shrinking because of lower global demand. Many LICs will also be hit by reduced remittances, and possibly lower aid. For net importers of food and fuel, the negative impact of these factors will be in part mitigated by the recent drop in food and fuel prices.

The Trade Channel

Trade has become a significant source of growth in LICs over the past 20 years. Trade openness, calculated as the ratio of the sum of exports and imports to GDP, has increased substantially since 1991 and has been accompanied by an acceleration of growth. Most LIC exports go to advanced economies, though this share has been declining.

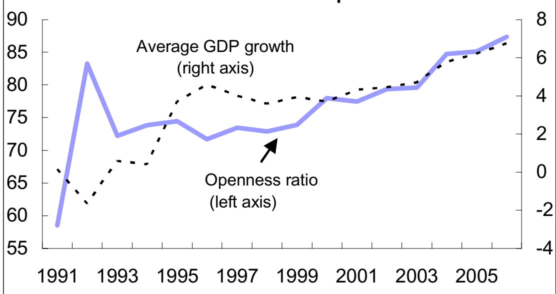
Openness and Trade Intensity in Low-Income Countries

(Averages, in percent)



Sources: IFS, Direction of Trade Statistics, Fund staff calculations.

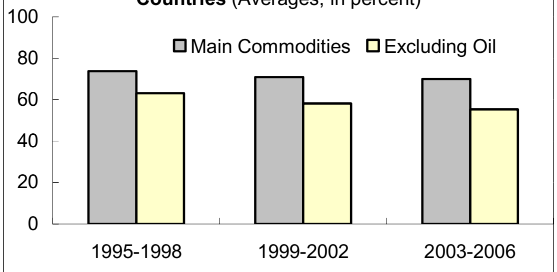
Growth and Trade Openness



Source: WEO database.

The structure of exports remains highly concentrated on commodities. In the past decade, the mean share of primary commodities in the exports of LICs has been close to 70 percent. The high concentration on commodities may further aggravate the impact of the global growth slowdown on LICs, to the extent that the demand for commodities is highly procyclical, with implications for both volumes and prices (WEO, 2001).

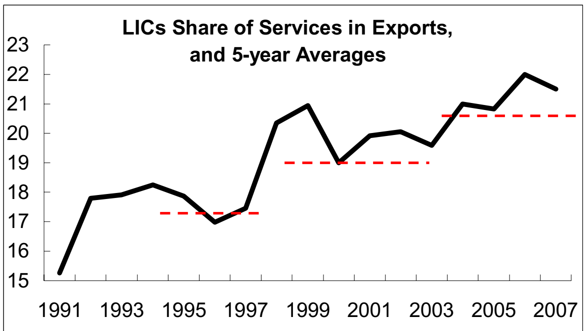
Share of Commodities in Exports in Low Income Countries (Averages, in percent)



Sources: UNCTAD Statistics, and Fund staff calculations.

LICs are more exposed than in the past to a downturn in global demand for services. The share of services in total LIC exports has trended upward over the past decade, the main activities being transportation and tourism. For 29 countries in the sample, services accounted for at least 30 percent of exports in 2007, while 8 countries are heavily dependent on services receipts (ratio of services receipts greater than 70 percent of exports).[13]

The latest projections illustrate the significant negative impact that LICs are likely to face in 2009 via the trade channel (Table 3). On average, projected current account balances for 2009 have deteriorated by about 3 percent of GDP since the April 2008 WEO, with a more pronounced decline in export growth than in import growth. The terms of trade are also projected to deteriorate, reflecting the sharp drop in commodity prices. The impact of declining trade in services, by contrast, appears limited.



Source: WEO database.

Table 3. WEO Projections; Selected Indicators

	2007	2008		2009	
		Spring WEO	Current Proj.	Spring WEO	Current Proj.
Goods					
Exports (Percent of GDP)	26.6	26.8	26.5	26.6	21.8
Imports (Percent of GDP)	40.1	40.6	42.5	39.7	38.6
Services					
Exports (Percent of GDP)	9.7	9.5	9.2	9.5	9.0
Imports (Percent of GDP)	12.2	11.8	14.2	11.2	13.6
Terms of trade (annual change in percent)	2.2	-0.4	-4.7	0.4	-0.7

Sources: WEO database, and Fund staff calculations.

Remittances

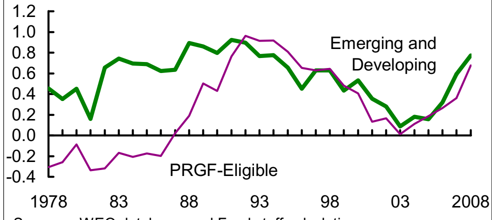
For many LICs, remittances constitute an important source of external financing, providing income to the poor and contributing to growth. At a global level, while data are weak, remittances are estimated to have increased at a double-digit annual rate since the 1990s (World Bank, 2006). In the past, they have been relatively stable compared to other external flows.[14] Remittance flows vary substantially across countries and regions, both from the recipient and country of origin point of view (World Bank, 2008).

[13]These include Cape Verde, Comoros, Djibouti, Dominica, Eritrea, Grenada, Maldives, St. Lucia, and St. Vincent and the Grenadines.

[14]For example, in sub-Saharan Africa, remittances have been less volatile than both official flows and FDI (Gupta, Pattillo, and Wagh, 2009).

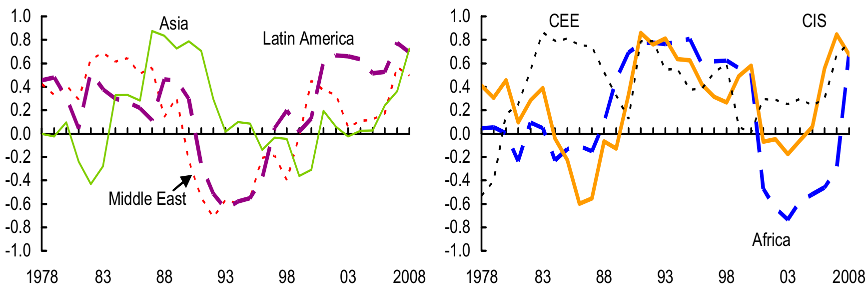
Box 3. Comovements in Output and Financial Markets

Output fluctuations in emerging and developing economies have been fairly synchronized with output fluctuations in the G-7 countries over the past 15 years. These linkages are quite important—a 1 percent change in real GDP growth in the G-7 countries is associated with a 0.4 percent change in growth in emerging and developing countries.[1/] For LICs, correlations have closely tracked those of other emerging and developing countries since the early 1990s.



Sources: WEO database, and Fund staff calculations.
1/ Rolling eight-year correlation windows.

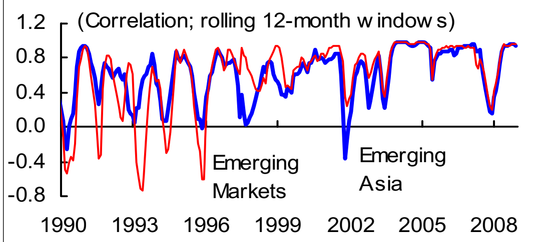
The degree of correlation has varied substantially over time and by region, reflecting idiosyncratic shocks in both emerging and developing countries and the seven major advanced economies. Notably, rolling moving averages of these correlations indicate that the comovement between the G-7 countries and emerging and developing countries in Asia, Latin America, and the Middle East fell markedly in the 1990s. This decrease appears to stem from the diversification of export markets away from the G-7 countries and the series of emerging market crises in Asia and Latin America. However, output synchronization between G-7 countries and economies in these regions has increased steadily since the late 1990s. In Africa, central and eastern Europe, and the Commonwealth of Independent States, comovements increased sharply in the run-up to the current crisis.



Sources: WEO database, and Fund staff calculations.

Financial channels are also becoming increasingly important as mechanisms through which shocks are transmitted between advanced and emerging economies, including LICs that are "frontier" emerging markets.

In particular, equity markets tend to be highly correlated and the correlation between advanced and emerging market equity prices has been rising over time. With the exception of the bursting of the dotcom bubble and initial divergence of equity markets in the 2007 in the current crisis, the correlation between G-7 and emerging economy equity markets has been near one for much of the past decade. As a result, capital flows—particularly in regions that depend more heavily on portfolio equity flows—are likely to be increasingly procyclical.



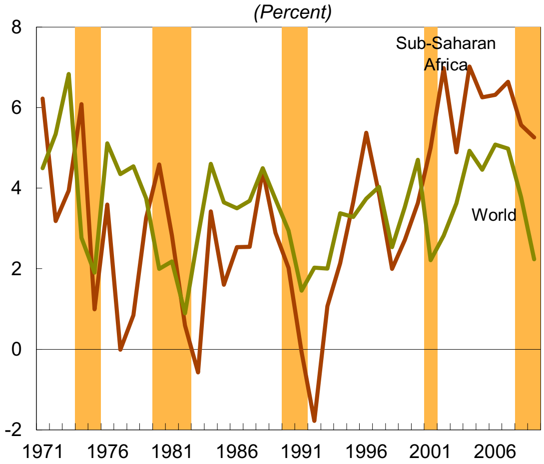
Source: Datastream; and IMF staff estimates.
1/ Twelve-month returns.

1/See IMF (2001). *World Economic Outlook*, Chapter II.

Box 4. Spillovers from the Rest of the World into Sub-Saharan Africa (SSA)

Historically, SSA growth has moved quite closely with global real GDP growth. As global growth slows, SSA is affected mainly by lower real external demand for its exports and declines in commodity prices and the terms of trade.

Sub-Saharan Africa and the World: Real GDP Growth[1]
(Percent)



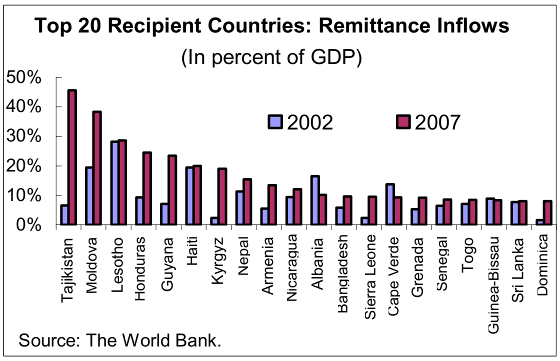
Source: IMF, *World Economic Outlook.*
[1] Periods of U.S. recessions shaded (National Bureau of Economic Research).

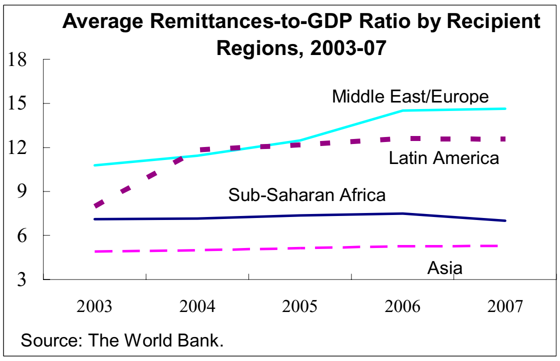
To quantify the impact of a global slowdown on individual African countries, a series of dynamic panel regressions were estimated for countries in the region, relating real growth in domestic output to world growth in trade weighted by partner countries and to several control variables: oil prices, non-oil prices, and country fixed effects. The sample includes data for 40 countries, over the period 1970–2007.

Three key results stand out:

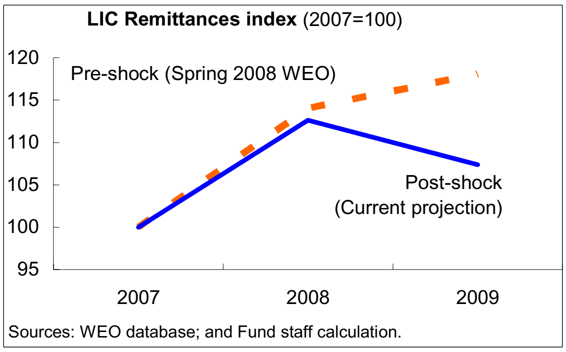
- A 1 percentage point slowdown in the rest of the world has led to an estimated ½ percentage point slowdown in SSA countries. The effect is partly felt contemporaneously (0.2 percentage point) and partly in the following year (0.3 percentage point).
- A nonfuel commodity-price-induced income reduction by 10 percent tends to reduce growth in sub-Saharan African exporters by about 1.5 percentage points after two years.
- An oil price shock tends to be significant only above a certain threshold (5 percent change in prices). A net oil importer in SSA (with oil imports of some 20 percent of GDP), facing a decline in oil prices of say 50 percent, could expect an increase in its growth rate by some 0.3–0.4 percentage point. The impact is linear on price changes above the threshold and on oil intensiveness of the economy. It appears symmetric for price increases and decreases.

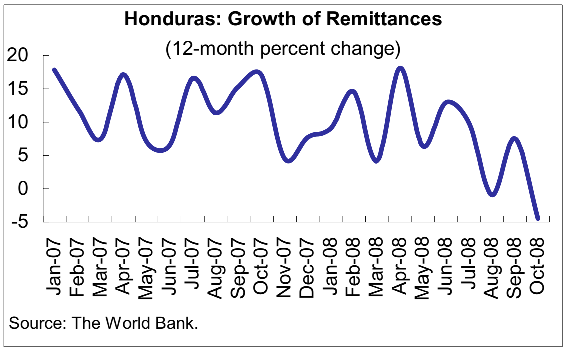
These estimates reflect the average effects for the average country and shock. While robust to different specifications, three important caveats are in order. First, while the cross-country regression estimates seem to be broadly in line with structural cross-country regressions in the literature, they explain only a small part of the growth variation experienced by SSA countries. This is because a broad range of domestic factors may be at play, and may plausibly interact with the shock itself to determine the effects; for example, the level of reserves, the policy response, and the expected persistence. Second, the specification does not control for the financial channel. Third, estimates reflect short-term effects of changes in the external environment on SSA growth.





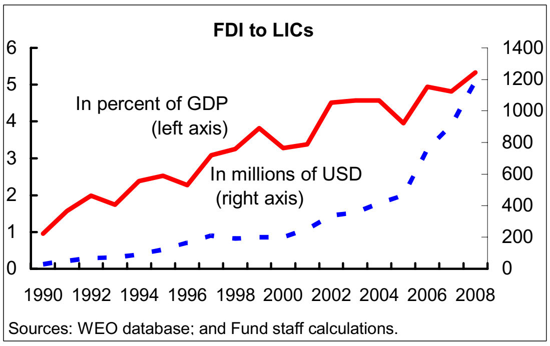
Current projections show remittances stagnating in the second half of 2008, and shrinking in 2009. The largest decline is expected in European, Asian, and Pacific LICs. Most recent evidence suggests that in some countries the decline in remittances can be substantial: in Honduras, for example, remittances declined by 4.5 percent in October 2008 (year-on-year).





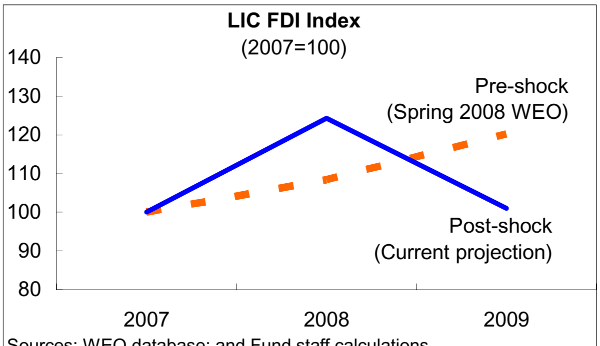
Foreign Direct Investment

Over the past two decades, the importance of FDI in LICs has grown dramatically. On average, FDI in LICs has quintupled (in percent of GDP) since 1990. The sources of investment have also diversified.[15]



[15]UNCTAD (2006).

FDI flows to LICs are expected to shrink sharply. Empirical evidence suggests that FDI in LICs is dependent on the health of the origin country's economy.[16] The latest WEO projections show FDI inflows for 2009 falling by almost 20 percent from their 2008 levels, compared to over 10 percent growth that was projected in the April 2008 WEO. Multinationals' reduced profit margins, combined with difficult financing conditions and volatile commodity prices (FDI in LICs is heavily concentrated in natural resource sectors), have already begun to trigger reduced FDI commitments for 2009–10. In Lao PDR and Mozambique, for example, FDI related to expansions of hydroelectric and mining projects has been delayed or suspended.



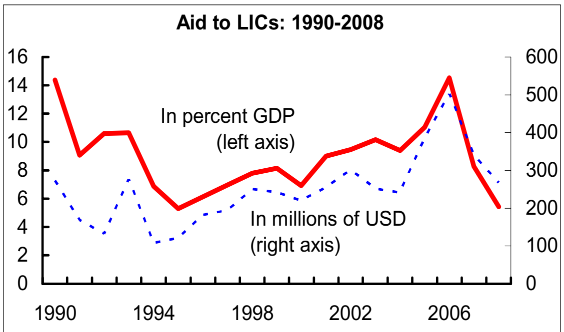
Sources: WEO database; and Fund staff calculations.

Overall, reduced FDI in 2009 is expected to have a significant impact in over half of all LICs. Countries in Latin America and Asia are expected to be most affected. In Africa, the impact is expected to be muted, due to FDI concentration in natural resource sectors, where new projects may be delayed but most ongoing projects are likely to be continued. The losses associated with withdrawing from natural resource projects prior to their completion, given the sizable up-front capital investment required for such investments, reduce the likelihood of FDI withdrawal.

Aid Flows

Poverty-reducing initiatives across the globe have led to sizable aid flows during this decade. Aid peaked in 2006, reflecting debt relief (driven by the HIPC and MDRI initiatives), coupled with increased flows from emerging donors such as Russia, China, and the GCC countries. However, excluding debt relief grants, net official development assistance remained broadly unchanged in real terms in 2006–07 (OECD, 2008a).

Potential reductions in aid flows are a serious concern. Empirical evidence shows that aid is procyclical with both donor and recipient incomes



Sources: WEO database; and Fund staff calculations.

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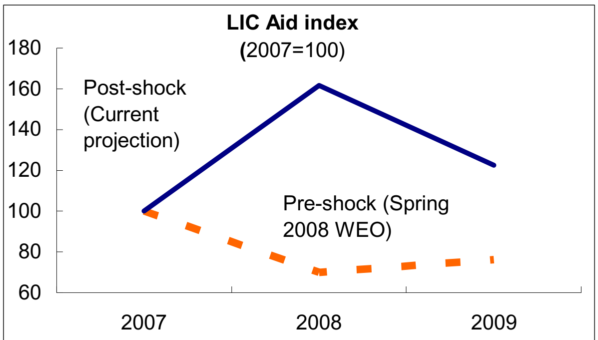
[16]World Bank (2004); Nonnemberg and Cardoso de Mendonça (2004); Kalotay and Sulstarova (2008).

(Bulíř and Hamann, 2006). In a sample of 18 donors, Pallage and Robe (2001) show that the comovements of total aid disbursements with donors' output were positive for almost three-fourths of donors during 1969–95. Given the severity of the slowdown in growth in advanced economies, a potential reduction in aid cannot be ruled out.

Projections of aid to LICs already started to decline in 2009. Growth in aid to LICs during 2008 was higher than initially anticipated by the WEO spring projections. This high level of projected aid partially reflected multilateral aid packages approved during late 2008 to help countries cope with food and fuel shocks experienced in early 2008. Notwithstanding international commitments to scale up aid, projections do not suggest such scaling-up is in the pipeline for 2009.



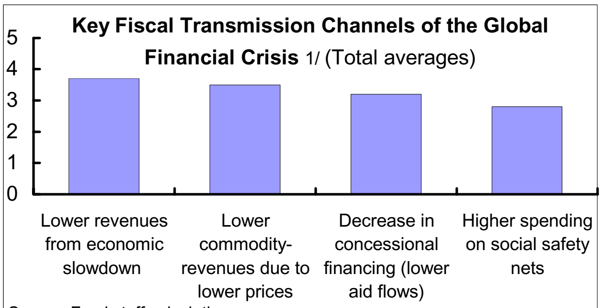
Sources: WEO database; and Fund staff calculations.

V. The Fiscal and Debt Sustainability Impact of the Crisis

Fiscal vulnerabilities are emerging as revenues decline, pressures on spending increase, and financing conditions deteriorate. The crisis will aggravate risks of debt distress in vulnerable countries.

Fiscal Impact

The financial crisis and global recession will aggravate the fiscal vulnerability of LICs. Budget revenues are expected to suffer as economic activity slows and commodity prices fall, pressures on spending rise, and financing conditions continue to tighten. The text chart shows a ranking of these factors, based on a survey of LIC country teams.

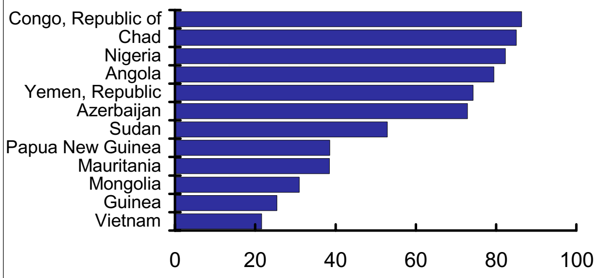


Source: Fund staff calculations.
1/ Rating: 5=Very important, 4=Important, 3=Somewhat important, 2=Unimportant, 1=Not applicable, and 0=no answer.

Revenue and Financing Prospects

Lower revenue is a key source of fiscal risk. The slowdown in economic activity and trade will affect fiscal revenues directly, given the reliance of many LICs on trade taxes. In addition, falling remittances from abroad can be expected to hit domestic consumption, and hence revenues from consumption taxes. The tourism industry, an important source of revenue in some LICs, is also likely to contract.

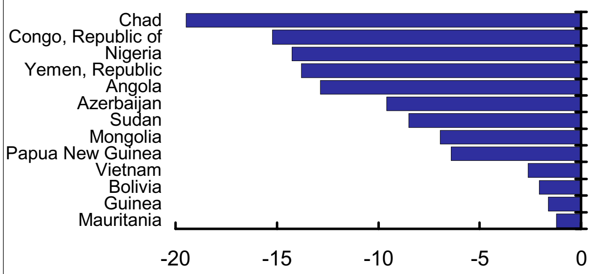
Commodity Revenues to Total Revenue, 2008
(Ratio, in percent of total revenue)



Source: Fund staff calculations.

Commodity revenues would be particularly affected—as emphasized by over half of country teams. In several countries, commodity-related revenues constitute more than 20 percent of total revenues. While all commodity exporters are likely to be hit in 2009, the effect is expected to be particularly marked for oil and metal producers, where the recent price declines have been steepest (e.g., Angola, Chad, Republic of Congo, Mongolia, Nigeria, and Yemen). The downturn has exposed some commodity exporters that embarked on ambitious spending plans on the basis of optimistic revenue assumptions. In countries where oil revenues accounted for at least 20 percent of total revenue in 2004, the average non-oil fiscal deficit rose from 22 percent of non-oil GDP in 2004 to 39 percent in 2008 as a result of rapidly rising expenditure.[17] This said, several countries (including Angola, Azerbaijan, the Republic of Congo, and Nigeria) accumulated fiscal cushions during the boom years, which now reduce their vulnerability.

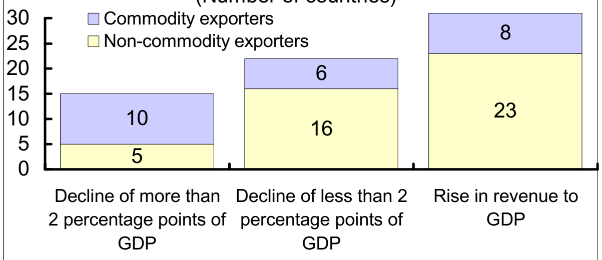
Change in Ratio of Commodity Revenues to GDP, 2008 to 2009 (Percentage points of GDP)



Source: Fund staff calculations.

Overall, revenue ratios are projected to decline in more than half of LICs in 2009. In close to a quarter of the countries, the decline is expected to be more than 2 percentage points of GDP. The extent to which revenue declines would contribute to vulnerability depends on the overall fiscal position and availability of financing. It should be noted that revenue losses will take place even if the revenue ratio is constant, due to lower activity. The expected increases in the revenue ratio in a number of countries mainly reflect ongoing efforts to strengthen revenue-raising capacity.

Change in Revenue to GDP Ratio; 2008 to 2009 1/
(Number of countries)

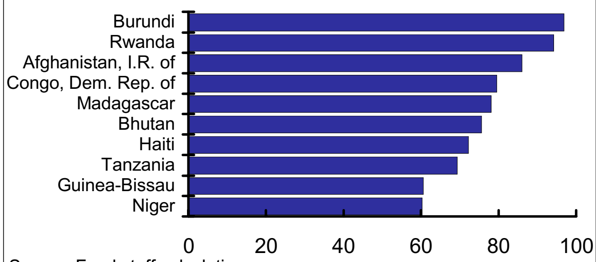


1/ Excluding grants.
Source: Fund staff calculations.

[17] Oil exports increased significantly in some countries, including Angola, Azerbaijan, and Timor-Leste.

Uncertainty about aid flows, potential declines in donor support, and tighter financing conditions are likely to impose further pressures on LICs' budgets. In about half of the countries, the ratio of aid to current spending exceeds 20 percent, and in 14 countries this proportion surpasses 50 percent. In particular, fiscal vulnerabilities are high in LICs where domestic revenue mobilization has not kept pace with rising public spending.[18] These countries have relatively small revenue bases, which limits their ability to increase tax collections in the short run to offset declines in aid flows. Falling aid was rated as very important or important by more than one-third of country teams. Countries such as Afghanistan, Burundi, and Rwanda are particularly vulnerable to declines in aid flows.

Ratio of Aid to Current Expenditure in 2008 for Large Recipients of Aid (In percent)



Source: Fund staff calculations.

Spending Pressures

Spending pressures may arise from various sources, starting with the sectors more directly affected by the external shock.

- ***Falling export revenues may exert pressure on government expenditures***. Commodity export sectors that are hit by lower demand and falling prices may seek government transfers to offset part of the falling revenues. This will happen if commodity marketing boards or state-owned export enterprises are called upon to subsidize domestic producers by maintaining higher domestic prices than the corresponding export prices.
- ***Poverty may increase with the slowdown in growth and falling commodity prices***. If output declines in capital-intensive industries (such as oil), the impact on employment would be limited, at least in the short run. However, in countries that export agricultural commodities, falling commodity prices would cut into rural employment and incomes, thereby increasing rural poverty. The urban poor, however, may benefit as food and energy prices decrease. Various estimates suggest that on average, when mean growth declines by 1 percentage point, the poverty head count increases by 2 percent.[19]
- ***Countries may need to expand social spending to address rising poverty levels***. Spending pressures to strengthen safety nets were considered important or very

[18] Gupta and Tareq (2008).

[19] The poverty elasticity to growth varies across countries; the estimated elasticity of two is the average obtained from a cross section of developing and transition countries. See Bourguignon (2003) and Ravallion (2004).

important by almost one-third of country teams. Countries that are already planning to expand or introduce new programs include Dominica, The Gambia, Guyana, Madagascar, Niger, and Senegal. On the other hand, countries that are net importers of food and fuel and that increased subsidies on these products during the 2007–08 price hikes should now be able to scale back their subsidies.[20] For example, in Pakistan and Yemen the reduction in international petroleum prices has helped create room for priority spending.

- ***The crisis could affect investment financing schemes.*** Public-private partnerships for public projects and concessions (such as ports and power generation) could come under strain because lower demand for services may trigger calls on revenue guarantees, and private operators may be affected by the credit crunch.

Additional spending pressures may arise from currency depreciation and rising interest rates.

- The share of foreign debt in public debt remains high (see next section), and depreciation would increase debt servicing costs. The cost of imported goods and services would also rise, thus offsetting, at least in part, the effect of lower commodity prices. Conversely, depreciation may boost border taxes (including duties and VAT on imports) and resource-related revenues.
- Countries able to access international capital markets may have to pay higher interest rates. For instance, the average spread of the four LICs included in the EMBI rose by about 1,000 basis points during the past year. And, as noted in the first part of Section IV, domestic funding costs have started to rise in a number of LICs—including Ghana, Mozambique, Pakistan, and Sri Lanka, according to the survey of country teams.

Public finances might also come under pressure if there is a need for government support to domestic financial institutions and depositors. Country teams expect that fiscal support to the financial system may be required in only a few countries (Cambodia, Comoros, Mongolia, and Pakistan), given the generally limited ties of financial systems in LICs to global financial markets. However, fiscal risks and vulnerabilities could emerge from contingent liabilities of the government and quasi-fiscal activities of central banks if it is decided to extend deposit guarantees (as some LICs have already done) or to direct or subsidize bank credit to the private sector.

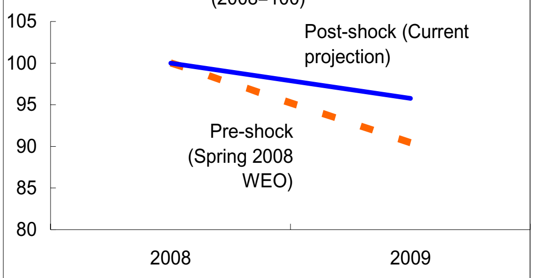
[20]IMF (2008). The median fiscal cost of fiscal policy responses to increasing fuel and food subsidies incurred since 2006 in a sample of 92 countries was estimated at 0.7 percent of GDP in September 2008. Fiscal costs were dominated by increases in fuel subsidies and reductions in fuel taxes. In 24 countries, the combined fiscal cost of fuel and food subsidies in 2008 was expected to exceed 2 percent of GDP.

The Impact of the Crisis on Debt Sustainability

In recent years, debt indicators in LICs have improved dramatically (Appendix III). Over the past decade, debt relief initiatives have significantly reduced the large external debts with which LICs have often struggled. With assistance from development partners, including the IMF and the World Bank, LICs have been working toward maintaining future debts at sustainable levels. Improved debt sustainability has helped create investor and donor confidence, as is evidenced by sizable FDI and aid flows to LICs over the past two years. A lower debt servicing burden has also freed greater resources for development spending.

However, higher borrowing to help offset the impact of the crisis could pose serious risks, in particular for those LICs that already have a high debt burden. Debt indicators are projected to continue improving in 2009 (see figure), albeit by less than forecast last spring. However, 28 countries already have debt in excess of 60 percent of GDP. Moreover, simulations of additional borrowing to offset the shortfalls in external financing suggest that a handful of countries that are currently on the verge of high risk of debt distress would breach this threshold (see Appendix IV). The simulations assume that reduced investment expenditure financing from aid and FDI is replaced with public external borrowing.[21] If sustained for one year, this adds 4 percent of GDP to the average LIC debt burden.

LIC Debt-to-GDP Index
(2008=100)



Sources: WEO database; and Fund staff calculations.

Second-round effects also pose serious risks to debt sustainability. Given that more than half of LICs' public debt remains external, a depreciation in exchange rates will aggravate the ratios of debt to GDP and fiscal revenues. Moreover, contingent liabilities resulting from pressures in the banking sector could further weaken the structural improvements in the sovereign balance sheet. Several governments have extended explicit or implicit guarantees for their banks' deposits in response to public uncertainty about domestic banks. Finally, the decline in reserves poses a risk to LICs' capacity to service or roll over external debt, which remains mostly at short maturities.

VI. Country Vulnerabilities and Risks of Further External Shocks

The external outlook varies widely across LICs and is subject to large risks. The baseline projections and illustrative scenarios suggest that 26 LICs could be particularly vulnerable.

[21] Aid and FDI are each assumed to be reduced by 30 percent of their respective 2008 values.

The growth and balance of payments repercussions of the global slowdown for LICs remain highly uncertain. Accordingly, this section analyzes LICs' short-run vulnerabilities to the global downturn on the basis of both the most recent projections and various simulations of possible further shocks that illustrate the downside risks to the baseline projections.

The baseline projections show large adverse effects of the global crisis for commodity and oil exporters, and countries with entrenched policy weaknesses (see Appendix V, Table 1). While, on average, projected growth in 2009 has been revised down by 2.1 percentage points relative to the April 2008 WEO, this decline amounts to more than 2.5 percent for 24 countries. Hardest hit are LICs in the Middle East and Europe and, to a lesser extent, Latin America and oil-exporting countries. Reserve coverage is projected to decline in 45 countries, by 0.6 month of imports, on average, with a particularly sharp drop among oil exporters.

Simulations of possible further shocks explore the balance of payments effects of lower prices of oil, commodities, and food; lower foreign demand for LIC manufacturing exports; and lower financial inflows. The simulations are simple partial equilibrium exercises to assess the immediate impact on the balance of payments and reserves of the assumed shocks to the trade balance (as a result of lower world market prices and export volumes) and to remittances, FDI, and aid.[22] The methodology is consistent with the one applied to the analysis of the food and fuel price shocks in IMF (2008b). The exercises do not incorporate further effects on growth or demand. For each channel, and for all shocks combined, countries are ranked in three vulnerability categories—high (H), medium (M), or low (L)—depending on the impact of these shocks on reserves.[23]

The simulation results illustrate the wide variation in vulnerabilities across LICs (Appendix V, Tables 2–7). Over 20 percent of the sample countries are highly vulnerable to the specified trade shock (lower world market prices and export volumes). The majority of these countries are in Africa. Of the 15 countries with remittances exceeding 10 percent of GDP in 2008, 10 appeared highly vulnerable to a decline in remittances. Overall, about half of the sample countries appear moderately vulnerable to a sudden decline in FDI. Countries

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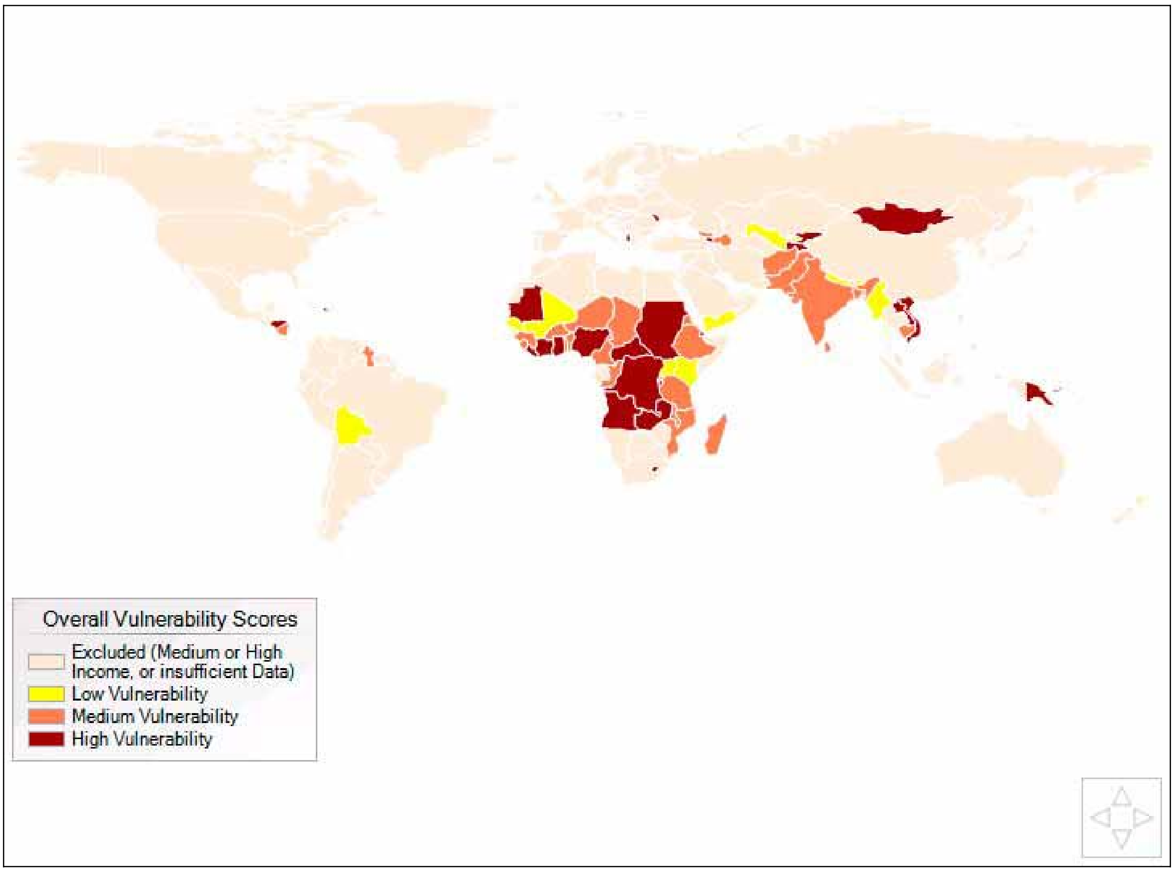
[22]The detailed specification of the shocks is described in Appendix V. In view of the limitations of the partial analysis, the simulation results are illustrative and should not be considered as actual projections at the country level. The final impact of the global slowdown is highly dependent on policy responses and domestic factors, as well as on the interaction of different shocks. In addition, the magnitude of the shocks in the simulations is not based on a projection of likely developments.

[23]The H category encompasses countries that had reserve coverage below the standard benchmark of 3 months of imports in 2008 and that could suffer an additional loss of reserves equivalent to more than 0.5 month in the shock scenario. Countries in the M category either start with more than 3 months of import coverage and lose more than 0.5 in the shock, or start below 3 months of coverage and lose less than 0.5 month with the shock. In the L category, countries start with more than 3 months of import coverage and lose less than 0.5 in the shock scenario.

Figure 2: Overall Country Vulnerabilities[1]



[1]See Appendix V, Table 1, for methodology. Country borders or names in this map do not necessarily reflect the IMF's official position.

in Latin America have relatively high FDI inflows, and hence almost all of them appear vulnerable to an FDI shock. Almost 50 percent of countries that received aid in excess of 10 percent of GDP in 2008 appeared highly vulnerable to reduced aid.

Considering both the current baseline projections and the simulations, 26 countries could be considered highly vulnerable to the adverse effects associated with the global recession (Figure 2 and Table 4). The baseline projections and simulations are combined to provide an overall vulnerability assessment. The most vulnerable countries are especially sensitive to trade, aid, and remittances shocks, while FDI appears to be a less important transmission channel.[24]

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[24]The results of this overall assessment are sensitive to the weights placed on the baseline projections relative to the simulations. The overall score is a weighted average of individual scores assigned to the change in projected 2009 real GDP growth relative to the April 2008 WEO projection, the projected change in reserves during 2009, and the vulnerability score in a simulation of combined further shocks. In this exercise, a GDP growth reduction (continued)

Table 4. Vulnerability Table

	Real GDP Growth	Reserves (in Months of Imports)	Vulnerability Score	
	2009 current less Spring WEO proj. 1/	2009 less 2008 2/	Simul. 3/ 4/	Overall Assessment 4/
Albania	-2.4	-0.7	M	H
Angola	-8.6	-1.0	M	H
Armenia	-5.0	-0.1	M	H
Burundi	-2.0	-0.6	M	H
Central African Rep.	-2.0	-0.9	H	H
Congo, Dem. Rep. of	-7.3	0.6	H	H
Côte d'Ivoire	-0.7	0.0	H	H
Djibouti	-1.5	0.2	H	H
Ghana	-3.4	-1.2	M	H
Haiti	-1.5	-0.3	H	H
Honduras	-2.6	-0.7	M	H
Kyrgyz Republic	-4.6	-0.1	M	H
Lao People's Dem.Rep.	-3.4	-0.9	M	H
Lesotho	-3.3	-0.8	M	H
Liberia	0.7	0.0	H	H
Mauritania	-2.8	-0.3	H	H
Moldova	-4.5	-0.2	M	H
Mongolia	-3.1	0.0	M	H
Nigeria	-5.0	-3.9	M	H
Papua New Guinea	0.2	-0.9	H	H
St. Lucia	-5.4	-0.1	M	H
St. Vincent & Grens.	-4.7	-0.2	M	H
Sudan	-6.7	0.2	H	H
Tajikistan	-4.0	0.0	H	H
Vietnam	-2.5	-0.9	M	H
Zambia	-2.4	0.2	H	H

1/ Current projection for 2009 less Spring WEO projection for 2009
2/ Current projection for 2009 less 2008 actual.
3/ Combined Shock: Trade, Remittances, Aid, FDI. See section IV for description of shocks and Appendix V tables for magnitudes of individual shocks.
4/ H = High risk; M=Medium risk; L=Low risk.
Sources: WEO database, and Fund staff calculations.

VII. Policy Recommendations

Many LICs have little room for countercyclical policies to address the impact of the global crisis. This highlights the importance of donor support, which will need to be stepped up to enable LICs to attenuate the effects of the crisis on poverty. Important domestic policy responses include targeted spending to protect the poor, exchange rate flexibility to facilitate adjustment, and vigilant financial supervision.

The ultimate impact of the global financial crisis on LICs is likely to be severe given their unique vulnerabilities and limited scope for offsetting policies. In principle, the choice between financing and adjustment in response to an adverse shock should depend on its expected duration, with temporary shocks calling for financing and permanent shocks requiring adjustment. While the evolving global crisis—and its effects on prices, foreign demand, and financial inflows—remains very uncertain, arguably many of its effects may be

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in excess of 2.5 percentage points, and a reduction in reserves in excess of 0.5 month of imports are considered "large." See Appendix V for details.

considered temporary. In practice, however, initial macroeconomic and debt conditions and available financing are likely to be the major factors determining the scope for fiscal easing.

Fiscal Policy

Fiscal policy responses to the crisis should take into account important characteristics of LICs and how the global crisis is affecting these countries.

- The fall in demand largely originates abroad and is transmitted to LICs through foreign trade as a reduction in exports—mainly commodities—due to lower prices and volumes. The ability of expansionary fiscal policy to substitute for this decline in external demand may be limited, to the extent that resources cannot quickly be reoriented across sectors. Attempts to maintain domestic demand through countercyclical fiscal policy could spill over into imports, resulting in a net loss of foreign reserves (absent more aid), or inflation.
- Most LICs lack effective social programs to transfer income.
- Governments cannot ease the fiscal stance as readily as in other countries because of liquidity constraints. Access to external financing is typically limited; thin domestic financial markets constrain the ability to finance higher fiscal deficits; and monetizing larger deficits would likely jeopardize macroeconomic stability.
- The significant uncertainty about whether the shock is temporary or long-lasting argues for cautious policy responses, as government revenues in the years ahead may remain weaker than in the recent past.

Against this background, the fiscal policy response should depend on country-specific circumstances.

- Countries without binding public debt sustainability and financing constraints that have achieved macroeconomic stability may have scope to accommodate the (cyclical) fiscal deterioration. This would help address the negative impact of the crisis on economic activity. A few countries may also have scope for discretionary fiscal stimulus aimed at sustaining aggregate demand. In all cases, the space for fiscal easing will depend on the availability of financing from external sources on concessional terms and the scope to raise and use domestic resources in a noninflationary manner, without draining international reserves or crowding out the domestic private sector, as this sector is the main source of long-term growth.[25]
- In formulating spending policies, priority should be given to protecting or expanding social programs or bringing forward approved investments, and, in general, to

[25]For example, financing constraints are an issue in WAEMU, where commercial banks that bought most of the bonds and bills issued by WAEMU governments increasingly face liquidity difficulties.

preserving the momentum toward achieving the MDGs. Most LICs have pressing infrastructure needs, and protecting or increasing spending in MDG-related sectors such as health, education, water and sanitation, and social protection can help cushion the impact of the crisis on vulnerable households. These countries may also want to reorient their spending composition in favor of programs that stimulate domestic economic activity. Spending that is intensive in domestic goods and services is likely to be more effective in supporting domestic activity. Existing infrastructure should be preserved by protecting spending on operations and maintenance. Initiating new infrastructure or social programs should be approached with caution because of the weak implementation capacity in many LICs. At a minimum, new projects considered for implementation should be properly appraised and prioritized.

- Some forms of spending increase would best be avoided. The subsidization of domestic exporters through the maintenance of higher domestic prices above export prices would not be well targeted, as large producers would benefit more. Public sector wage increases would also be a poorly targeted form of support and may not be sustainable.

Commodity exporters that built financial cushions during the boom may be in a better position to maintain spending or adjust gradually. Exporters with no sustainability or financing concerns despite the downturn in commodity prices may be in a position to maintain spending levels. Some countries that need to retrench because of sustainability issues might be able to do so gradually if they had built up financial cushions.[26]

However, many countries will be forced to adjust their fiscal position. Those countries with binding fiscal constraints, including some commodity exporters, will have to address a deteriorating fiscal position.

Those countries can create fiscal space for additional spending or to preserve priority spending, including for MDGs. They can do so through increasing revenue or reprioritizing spending.

- *Countries with low tax-to-GDP ratios should try to mobilize additional domestic revenue*. A tax-to-GDP ratio of 15 percent is considered a reasonable target for most LICs, and many non-resource-rich LICs have tax-to-GDP ratios well below this target. This does not mean that tax rates should be increased. Indeed, in some countries, high rates, particularly on mobile production factors (such as skilled labor and capital), may be hindering economic growth. In many LICs, low revenues are mainly associated with narrow tax bases, rather than low rates. In these countries, a rationalization of tax incentives (by reducing exemptions, tax holidays, and deductions) together with strengthening of revenue administration should allow lower

[26]Barnett and Ossowski (2003).

tax rates while mobilizing additional revenues. However, these reforms—which should be part of a medium-term strategy—take time. This said, countries should carefully review the scope for removing tax exemptions in the context of the next budget, with a view to generate revenue. Resource-rich countries should continue to make efforts to diversify their revenue base, which would reduce fiscal risks.

- *Fiscal space can also be created through expenditure rationalization and increasing spending efficiency*. This is important in light of the difficulty of raising revenues through quality measures in the short run. Reducing unproductive expenditures, particularly those of a recurring nature, while often politically difficult, should be the first option. Examples include generalized subsidies, transfers to loss-making enterprises, excessively large government employment, and “white elephant” projects. Many countries increased subsidies in response to the surge in international fuel prices in recent years. With the fall in these prices, the fiscal cost of the subsidies should decline.[27] Strengthening public financial management systems would contribute to improving expenditure efficiency, by ensuring that resources reach their intended users. It is important to avoid across-the-board spending cuts, which can lead to arrears and inefficiencies, and are often not sustainable.

In all cases, spending plans should preferably be cast in a medium-term framework (MTF). Increases in spending that would not be sustainable in the future should be avoided. While the design and implementation of an MTF is a complex process that should be approached gradually, many LICs could make greater efforts in this area.

Care will have to be taken in strengthening safety net programs. Transfer programs that effectively target the poorest often result in a larger stimulus to aggregate demand, given their higher propensity to consume.[28] The capacity of many LICs to put in place new targeted programs will be limited in the near term.[29] There may be scope, however, to scale up existing spending programs in targeted ways:

- *Countries can implement public works programs and/or provide income supplements through existing programs.* Labor-intensive infrastructure projects can be effective in providing income support to the poor while simultaneously delivering fiscal stimulus. Setting the wage rate relatively low ensures that the schemes are self-targeted to the poor. The going wage for unskilled agricultural labor is often a good benchmark.

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[27]This may also be an opportune time to reform domestic pricing mechanisms (e.g., from ad hoc price adjustment systems to automatic price formulas or price liberalization) where appropriate.

[28]Strengthening such programs would also reinforce automatic stabilizers. In countries with financing constraints, however, the operation of such stabilizers would require flexibility in other spending areas.

[29]Initiatives undertaken in response to the fuel and food price crisis have improved the situation in some countries.

- *Additional resources can be channeled to targeted programs, such as targeted food distribution or school meal programs.* Expanding conditional cash transfer programs that link cash transfers or subsidies to the receipt of health care or education can be an effective method of addressing potential losses in human capital. Examples of such programs include the Primary Education Stipend Program in Bangladesh, *Bolsa Familia* in Brazil, the Education Sector Support Program in Cambodia, *Programa de Asignación Familiar* in Honduras, *Oportunidades* in Mexico, and *Atención a Crisis* and *Red de Protección Social* in Nicaragua.

Monetary and Exchange Rate Policy

An important policy priority will be to maintain domestic macroeconomic stability amid deteriorating terms of trade. With declining food and fuel prices, inflationary pressures are quickly receding in the large majority of LICs. At the same time, and unlike in some advanced economies, risks of deflation seem limited for LICs. Sharp depreciations in the wake of balance of payments pressures clearly have the potential to feed through to inflation, offsetting the deflationary global environment. Accordingly, while there may be scope for monetary easing in some countries with falling inflation, countries experiencing continued or renewed price pressures may need to tighten monetary policy.

Inflationary challenges remain in some LICs where existing aggregate demand pressures have yet to be effectively tackled. In 18 LICs, inflation still exceeded 15 percent as of end-December 2008 and for 12 of these it is forecast to remain in double digits throughout 2009, as earlier commodity price increases are still feeding through to the economy, and have affected wage demands and inflation expectations. Most of these cases have been associated with relatively loose monetary and/or fiscal policies—including in the form of recent high wage awards (Mongolia), an expansionary deficit (Ghana, Ethiopia), and negative real interest rates (Azerbaijan).

Countries with flexible exchange rates should allow them to function as shock absorbers in response to the negative external shock stemming from the financial crisis. It will generally not be effective to impede needed adjustment in the real exchange rate or dissipate reserves through intervention, which should be limited to responding to temporary instances of disorderly market conditions.

Countries with fixed exchange rates may face different challenges, with pressure on these arrangements owing to lower net exports, together with, potentially, capital flight and a reduction in available external financing. In light of the adverse shocks, exchange rate competitiveness and the adequacy of reserves will need to be carefully assessed. For countries with de facto rather than formal pegs, in particular, introducing some degree of exchange rate flexibility may be advisable (e.g., Armenia, Ethiopia). If the financial crisis is prolonged, the pattern of external adjustment—including the use of exchange rates—would shift over time. While exchange rate adjustment may be avoided in the short term, extended balance of payments pressures could make adjustment unavoidable.

Protectionist measures should be avoided. Limiting imports through tariffs or quantitative restrictions lowers welfare by distorting incentives, and new barriers can be hard to rescind when the current pressures subside.

Financial Sector

As mentioned above, potential negative fallout from the crisis on LICs' financial system remains high. In this context, LICs need to focus on immediate crisis prevention measures including by preparing contingency and remediation plans for the financial system.

In the short term, it will be critical to monitor the risks and take actions that focus on reducing uncertainty and engender confidence. Dynamics in domestic debt and financial markets can have serious spillover effects on the domestic banking system and hence on credit availability. Analysis of such linkages should be undertaken at both the institutional and systemic levels.

At the private sector level, financial institutions could initiate balance sheet repair. Where capitalization is weak, fresh equity may need to be raised or medium-term funding sources sought, even if the cost of doing so is high. A critical evaluation should also be undertaken of institutions' overall risk management systems, particularly for liquidity and counterparty risk management. Stress tests should be conducted to identify potential balance sheet vulnerabilities, account for possible longer periods of funding illiquidity, and develop firm-specific contingency plans. These should guide the formulation of appropriate adjustments in risk management.

Similar steps are required for the official sector. The channels through which risks could materialize should be subject to high-frequency monitoring, and countries should review their crisis management frameworks. Prudential rules should be rigorously enforced, and supervision extended to key non-bank institutions and local capital markets. Given the possibility of direct interventions utilizing the government balance sheet, official reserve holdings should be carefully monitored. Likewise, debt management would need to focus increasingly on liquidity risks in addition to the sovereign's solvency, take account of the maturity structure and nonresident holdings of locally issued debt, and optimize the mix between local-currency domestic debt and external borrowing.

Countries could also improve coordination amongst the government, the central bank, and supervisory agencies. This will facilitate anticipation of liquidity and solvency problems. It will also help avoid a "rush to regulate" that may create further illiquid conditions or a credit squeeze, or a culture of non-repayment of bank loans. Central banks must have reliable access to financial information of all regulated financial institutions. The medium-term agenda of the financial sector reforms process should remain on track, or even be advanced. Deepening money and foreign exchange markets and developing the investor base will help to improve liquidity management. Progress would depend on implementing appropriate monetary policy frameworks, operating procedures, and instruments; improving central bank liquidity forecasting and its coordination with government cash management; and strengthening inter-bank money and foreign exchange markets, the shallowness of which often leads to excessive volatility. Reform of the non-bank financial sector can be a powerful tool to increase the demand for longer maturities and reduce rollover risks.

VIII. Financing Needs of LICs as a Result of the Crisis

The additional financing needs of LICs resulting from the crisis could amount to about US$25 billion in 2009, and could rise much further.

At this stage, any projection of LICs' balance of payments needs in light of the global financial crisis should be considered as highly tentative. Previous sections have highlighted the uncertainties surrounding the many variables that feed into a calculation of financing needs. Nevertheless, in this section we offer some preliminary estimates of the amount of additional external financing that LICs would need in order to withstand the crisis-related shocks without excessive import contraction or depletion of reserves.[30]

Current baseline projections for 2009 suggest an aggregate additional financing need for LICs of about US$25 billion (Table 5). However much larger financing needs would result without import adjustment or if various downside risks were to materialize. The reserve level for end-2009 that was projected in the April 2008 WEO projections serves as the benchmark for calculating the additional financing need.

- Current projections foresee an adverse balance of payments shock for 38 LICs in 2009, amounting to about US$165 billion in total, relative to the April 2008 projections (Table 5 and Appendix VI). However, various downside risks to the baseline could result in a much larger impact, as illustrated in the "bad case" scenario. In this scenario, the shocks described in the simulation of Section VI occur simultaneously, with an overall balance of payments impact of US$216 billion.[31]

[30]The analysis in this section focuses on the availability of foreign exchange reserves at the level of the central bank. In practice, actual import adjustment depends not only on the total financing available to the country, but also on its availability to specific groups—households, firms, and public entities—many of which are liquidity constrained and may have no alternative but to contract their spending in response to adverse shocks.

[31]This simulation differs from the one for a combined shock in Section VI, in that it does not include a downward shock to aid. Otherwise, the estimated financing need—which can be considered the need for aid—would be artificially augmented by an ex ante aid decline.

Table 5. LIC Balance of Payments Shock and Financing Needs in 2009 1/

	Current 2009 proj.		**"Bad case" scenario 2/**	
	(in US$, billions)	number of countries	(in US$, billions)	number of countries
Total balance of payments shock 3/	**165**	38	**216**	60
Total reserves loss 4/	**131**	35	**216**	60
Additional financing need 5/	**25**	22	**138**	48

1/ All changes are relative to the Spring 2008 WEO projection for 2009. See Appendix VI for details.

2/ This corresponds with the simulated combined shocks to exports, remittances, and FDI described in Section VI and Appendix V.

3/ The sum of the shocks to exports, FDI, remittances, and the price effects of food and fuel price changes (but excluding import responses).

4/ The total change in reserves for LICs with reserves losses.

5/ The total change in reserves for LICs with reserves coverage falling below 3 months of imports or by more than 0.5 months to less than 4 months.

Sources: WEO database, and Fund staff calculations.

- Since the projections incorporate some policy adjustment and import compression in response to the crisis, these shocks are projected to result in a loss of reserves in 35 LICs. The total decline in reserves (again, relative to the spring 2008 projection) for these countries amounts to US$131 billion.[32]
- In 22 LICs, reserves are now expected to fall below 3 months of imports.[33] The total reserves loss in these countries amounts to US$25 billion—equivalent to about 80 percent of the annual aid received by LICs over the past five years (based on OECD Development Assistance Committee data). This represents a minimal estimate of the additional financing need. Support on a larger scale would be needed to help countries avoid the procyclical adjustment that is assumed in the projections, including in countries that may not see significant balance of payments needs but face increased budgetary pressures. In addition, if the adverse shocks turn out to be larger than expected, more support would be needed, as shown in the "bad case" scenario.

IX. Fund Support

The Fund is working actively with its partner institutions and national authorities to assess the economic and balance of payments impact of the financial crisis on LICs, and assist them through policy advice, financing, and technical assistance.

The Fund will provide financial support to LICs hit by the crisis in a manner that responds to their economic circumstances, the nature of the balance of payments problem, and their existing program relationship, if any, with the Fund:

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[32]As the "bad case" scenario does not incorporate any policy responses, the reserve loss in this scenario equals the total balance of payments impact of the shocks.

[33]Also including cases where reserves fall by more than 0.5 month of imports, to less than 4 months.

- For countries with existing PRGF arrangements, an augmentation of the arrangement is generally the appropriate mechanism. In 2008, 11 such augmentations were granted in response to the food and fuel price shocks.
- For countries without an existing IMF arrangement, the revised Exogenous Shocks Facility (ESF) may be a suitable mechanism for IMF financing to the extent that the shock is of an exogenous nature. In December 2008 and January 2009, 5 countries benefited from support under the ESF.
- For countries with balance of payments needs that might require longer-term program engagement, a new PRGF arrangement may in principle be the most appropriate instrument, owing to its longer horizon and greater structural focus.
- The Fund has also launched a broad review of its financial facilities, including for LICs, to ensure its assistance is best tailored to its members' needs.

The Fund also has an important role to play in providing policy advice to members responding to a more demanding macroeconomic and financial environment. Surveillance may be particularly relevant as a tool for ex ante LIC crisis prevention/mitigation efforts and for those LICs that are not yet in a position to implement Fund-supported programs, and/or lack the capacity to absorb technical assistance.

In several areas, LICs are likely to need enhanced technical support. Most LICs face significant capacity constraints. The Fund, along with its partners, may need to scale up the provision of technical assistance (TA) to help LICs address the crisis and continue moving ahead with broader public and financial sector reforms. Concerning the latter, the Fund could help implement best practices in crisis management, balance sheet risk management, and debt and liquidity risk management. The upcoming FSAPs in the LICs could focus on these areas. Several countries have set up crisis management committees and technical groups, which the Fund can support. TA also plays an important role for members faced with the need to strengthen public expenditure management systems, enhance domestic revenue, and improve debt management.

Appendix I. Countries Included in the Analysis

The group of LICs analyzed in the paper is formed by the 71 PRGF-eligible countries for which data were available, which include, by region:

Sub-Saharan Africa

Angola, Benin, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Eritrea, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mali, Mauritania, Mozambique, Niger, Nigeria, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Somalia, Tanzania, Togo, Uganda, and Zambia.

Middle East and Europe

Albania, Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Sudan, Tajikistan, Uzbekistan, Republic of Yemen.

Asia

Afghanistan, Bangladesh, Bhutan, Cambodia, India, Lao People's Democratic Republic, Mongolia, Myanmar, Nepal, Pakistan, Papua New Guinea, Sri Lanka, Vietnam.

Latin America

Bolivia, Dominica, Grenada, Guyana, Haiti, Honduras, Nicaragua, St. Lucia, St. Vincent and the Grenadines.

Appendix II. The April 2008 WEO Projections and the Most Recent Updates

Table 1. Selected Economic Indicator Projections, Spring 2008, and Current Projection
(In percent average, unless otherwise indicated)

	WEO Spring 2008						Current Projections					
	GDP growth		Reserves (months of imports 1/)		Current Acc. Balance 2/ in percent of GDP		GDP growth		Reserves (months of imports 1/)		Current Acc.Balance 2/ in percent of GDP	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
Afghanistan, I.S. of	8.6	8.4	3.2	3.1	0.0	-1.0	3.6	7.7	3.2	3.5	-2.8	-2.3
Albania	6.0	6.1	3.9	3.8	-8.3	-5.5	6.0	3.7	4.8	4.1	-10.0	-7.5
Angola	16.0	13.2	6.1	7.3	12.0	11.8	12.2	4.6	4.1	3.1	5.8	1.3
Armenia	10.0	8.0	3.7	3.7	-6.8	-5.0	6.8	3.0	3.6	3.5	-13.7	-12.9
Azerbaijan	18.6	15.6	6.3	6.9	39.5	39.2	9.5	8.0	5.9	7.1	30.9	10.9
Bangladesh	5.5	6.5	2.4	2.4	-0.5	-0.7	5.0	5.3	2.7	2.7	0.7	0.5
Benin	5.4	5.7	8.2	7.9	-6.1	-6.0	5.1	3.6	7.5	6.9	-9.6	-8.3
Bhutan	7.8	6.7	10.7	10.8	9.5	2.3	6.6	5.7	11.9	11.7	11.7	2.8
Bolivia	4.7	5.0	9.8	10.3	12.3	8.6	5.9	4.0	14.9	14.2	11.0	-4.3
Burkina Faso	4.0	6.3	5.4	4.9	-11.5	-10.7	4.5	4.0	6.0	5.4	-11.3	-9.5
Burundi	5.9	5.7	3.3	4.4	-12.0	-12.2	4.5	3.7	4.4	3.8	-12.5	-8.0
Cambodia	7.2	7.0	2.3	2.2	-5.4	-6.2	6.5	4.8	3.3	2.9	-11.9	-7.1
Cameroon	4.5	4.6	5.7	6.5	0.0	-0.4	3.7	3.5	6.8	6.1	0.4	-5.4
Cape Verde	7.7	7.4	3.4	3.5	-11.6	-12.8	6.0	5.0	3.1	3.2	-13.0	-12.7
Central African Rep.	4.9	5.0	1.6	1.7	-6.4	-6.7	2.8	3.0	3.4	2.5	-8.7	-7.2
Chad	1.8	2.5	3.8	4.4	-2.2	-4.0	-0.4	3.6	5.6	3.5	-9.5	-19.6
Comoros	1.6	3.0	7.6	7.2	-3.5	-4.3	0.5	0.8	6.8	6.3	-8.7	-8.3
Congo, Dem. Rep. of	8.8	11.6	0.4	0.5	-10.7	-24.6	8.2	4.4	0.7	1.3	-12.4	-19.8
Congo, Republic of	9.2	10.6	7.8	14.3	6.0	10.9	7.6	10.3	8.3	7.1	-0.8	-18.1
Côte d'Ivoire	2.9	5.1	2.8	2.7	0.6	-0.5	2.9	4.4	2.8	2.8	0.1	-2.6
Djibouti	6.5	7.6	2.3	2.7	-22.6	-17.8	5.9	6.0	2.8	3.0	-38.2	-14.0
Dominica	3.5	3.0	3.5	3.5	-26.6	-23.9	2.6	1.5	6.6	6.7	-30.1	-24.4
Eritrea	1.2	2.0	2.1	1.7	-5.1	-5.5	1.2	1.6	1.1	0.9	-2.7	1.1
Ethiopia	8.4	7.1	1.5	1.6	-4.3	-6.1	11.6	6.5	1.2	1.7	-5.8	-5.9
Gambia, The	6.5	6.5	3.8	4.0	-12.1	-10.9	5.5	6.0	4.5	4.2	-13.9	-12.5
Georgia	9.0	9.0	1.8	1.6	-16.6	-13.2	2.0	2.5	2.7	3.1	-21.8	-17.7
Ghana	6.9	7.5	1.7	1.5	-9.8	-7.9	6.5	4.0	1.8	0.6	-20.2	-15.9
Grenada	4.3	4.0	2.6	2.5	-25.4	-25.8	1.6	0.6	3.0	3.2	-31.8	-31.8
Guinea	4.9	5.2	1.4	2.1	-10.9	-9.8	4.7	4.1	1.5	2.0	-4.1	-2.6
Guinea-Bissau	3.2	3.1	7.4	8.1	7.0	2.8	3.2	3.1	6.1	6.8	0.2	-11.6
Guyana	4.6	4.5	2.3	2.1	-16.6	-15.8	3.2	4.6	3.1	3.0	-20.8	-18.1
Haiti	3.7	4.0	2.0	2.1	-1.3	-2.5	1.3	2.5	3.1	2.8	-2.6	-4.4
Honduras	4.8	4.6	2.9	3.0	-9.5	-9.0	4.0	2.0	3.1	2.3	-13.3	-8.3
India	7.9	8.0	9.2	8.8	-3.1	-3.4	7.3	5.1	9.7	8.8	-2.5	-1.8
Kenya	2.5	3.4	3.2	3.0	-5.5	-3.8	2.0	3.0	3.2	3.5	-6.6	-2.7
Kyrgyz Republic	7.0	6.5	3.3	3.3	-8.3	-7.4	7.5	1.9	3.6	3.4	-6.0	-6.5
Lao People's Dem.Rep	7.9	8.2	2.2	2.5	-21.7	-15.5	6.8	4.8	3.1	2.2	-15.1	-11.9
Lesotho	5.2	5.4	7.8	8.5	5.0	4.5	3.9	2.1	6.7	5.9	-3.7	-8.5
Liberia	9.5	10.2	0.6	0.6	-42.1	-36.2	7.1	10.9	0.7	0.7	-31.8	-42.2
Madagascar	6.8	7.3	2.5	2.9	-27.4	-16.7	7.0	5.1	2.8	3.3	-22.6	-14.8
Malawi	7.1	6.2	1.9	2.4	-2.9	-4.4	8.0	6.6	0.9	1.3	-8.0	-4.6
Maldives	4.5	4.0	1.4	2.3	-35.7	-19.2	6.5	6.5	2.7	3.5	-46.0	-30.1
Mali	4.3	5.1	5.4	5.6	-7.5	-6.7	4.9	4.4	5.1	5.2	-6.1	-6.2
Mauritania	6.1	6.8	3.4	3.5	-8.6	-12.0	4.9	3.9	1.1	0.7	-6.1	-8.6
Moldova	7.0	8.0	3.2	3.6	-10.3	-10.6	6.5	3.5	3.3	3.1	-18.9	-19.2
Mongolia	8.7	8.1	4.4	4.5	-17.1	-17.6	9.8	5.0	2.3	2.3	-9.2	-7.1
Mozambique	7.0	7.0	4.2	4.5	-11.3	-10.3	6.2	5.5	4.9	4.8	-12.7	-11.8
Myanmar	4.0	4.0	3.8	3.8	2.9	2.0	4.5	5.0	0.7	0.7	3.3	1.3
Nepal	4.0	4.5	4.2	3.7	0.5	0.2	4.7	4.6	7.2	7.2	2.6	3.3
Nicaragua	4.0	4.2	1.4	0.8	-24.8	-24.4	3.0	1.5	2.7	2.8	-23.6	-17.7
Niger	4.4	4.5	3.4	3.3	-9.7	-14.0	5.9	4.5	3.9	3.1	-9.9	-22.6
Nigeria	9.1	8.3	14.8	18.7	6.5	5.7	5.3	3.3	14.2	10.3	5.0	-10.7
Pakistan	6.0	6.7	3.2	3.1	-6.9	-6.1	5.8	2.0	2.4	2.8	-8.4	-4.7
Papua New Guinea	5.8	4.7	4.1	4.2	3.3	1.7	7.0	4.9	5.7	4.9	3.2	-5.5
Rwanda	6.0	5.6	4.9	4.8	-9.5	-12.7	8.5	6.0	5.5	4.8	-6.9	-7.6
São Tomé & Príncipe	6.0	6.0	6.2	6.0	-36.1	-32.9	5.8	5.5	4.3	3.9	-34.0	-43.0
Senegal	5.4	5.9	3.7	3.8	-10.3	-11.1	3.9	4.5	3.5	3.6	-12.4	-10.4
Sierra Leone	6.5	6.5	3.4	3.7	-6.4	-5.9	5.5	5.0	3.6	3.5	-6.8	-4.5
Sri Lanka	6.4	5.6	2.5	2.5	-5.7	-4.9	6.0	3.8	1.6	1.5	-7.7	-5.9
St. Lucia	4.4	4.4	2.2	2.1	-18.5	-17.9	1.7	-1.0	2.2	2.1	-29.5	-23.7
St. Vincent & Grens.	5.0	4.9	2.2	2.0	-26.7	-23.3	1.9	0.2	2.6	2.4	-34.1	-28.4
Sudan	7.6	12.7	1.5	2.9	-9.8	-5.6	8.5	6.0	1.4	1.5	-7.0	-10.0
Tajikistan	4.1	7.0	0.8	1.0	-8.3	-7.1	7.9	3.0	0.6	0.5	-8.9	-8.6
Tanzania	7.8	8.0	4.3	3.8	-9.7	-10.1	7.0	5.3	5.6	5.8	-9.9	-8.6
Togo	3.0	4.0	2.6	2.5	-7.9	-6.7	0.8	2.0	3.5	3.2	-7.0	-6.4
Uganda	7.1	7.0	6.4	6.1	-7.7	-9.3	9.5	6.0	7.5	6.9	-6.1	-7.9
Uzbekistan	8.0	7.5	16.1	17.6	24.6	20.8	9.1	7.0	10.5	11.3	13.5	7.3
Vietnam	7.3	7.3	2.6	2.3	-13.6	-11.9	6.2	4.8	4.5	3.6	-10.3	-8.2
Yemen, Republic of	4.1	8.1	10.8	10.5	-1.4	0.9	3.9	7.7	13.2	11.6	-2.1	-2.8
Zambia	6.3	6.3	3.0	3.5	-5.5	-3.9	5.8	4.0	3.2	3.3	-8.9	-8.3

Sources: WEO database, and Fund staff calculations.
1/ Next year imports of goods and services.
2/ Including current transfers.

Table 1 continued. Selected Economic Indicator Projections, Spring 2008, and Current Projection
(In percent average, unless otherwise indicated)

	WEO Spring 2008						Latest Projections					
	GDP growth		Reserves (months of imports 1/)		Current Acc. Bal. 2/ in percent of GDP		GDP growth		Reserves (months of imports 1/)		Current Acc. Bal. 2/ in percent of GDP	
	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009
All LICs	6.2	6.4	4.2	4.5	-7.7	-7.3	5.4	4.3	4.4	4.2	-9.6	-10.2
Sub-Saharan Africa	5.9	6.3	4.3	4.8	-7.7	-7.9	5.3	4.6	4.3	3.9	-8.9	-11.0
Asia	6.5	6.4	4.0	4.0	-6.7	-5.7	6.2	5.0	4.4	4.2	-6.6	-5.5
Middle East and Europe	8.0	8.7	4.9	5.2	-2.6	-1.0	6.7	4.8	4.8	4.8	-7.5	-7.4
Latin American countries	4.3	4.3	3.2	3.1	-15.2	-14.9	2.8	1.8	4.6	4.4	-19.4	-17.9
Net Oil importers	5.9	6.0	3.5	3.6	-10.9	-10.1	5.2	4.1	3.8	3.6	-12.7	-11.3
Net Oil exporters	7.3	7.9	6.5	7.5	3.4	2.3	5.9	5.1	6.7	6.0	0.8	-6.5
Countries according to their per capita income												
top 25%	7.7	7.0	4.0	4.5	-9.3	-7.6	5.5	3.9	4.2	4.1	-13.7	-13.6
mid 50%	5.5	6.3	4.8	5.0	-6.3	-5.9	5.1	4.1	5.0	4.6	-8.0	-8.7
bottom 25%	6.0	6.2	3.3	3.4	-8.8	-9.5	5.9	5.2	3.5	3.4	-8.7	-9.8

Sources: WEO database, and Fund staff calculations.

1/ Next year imports of goods and services.

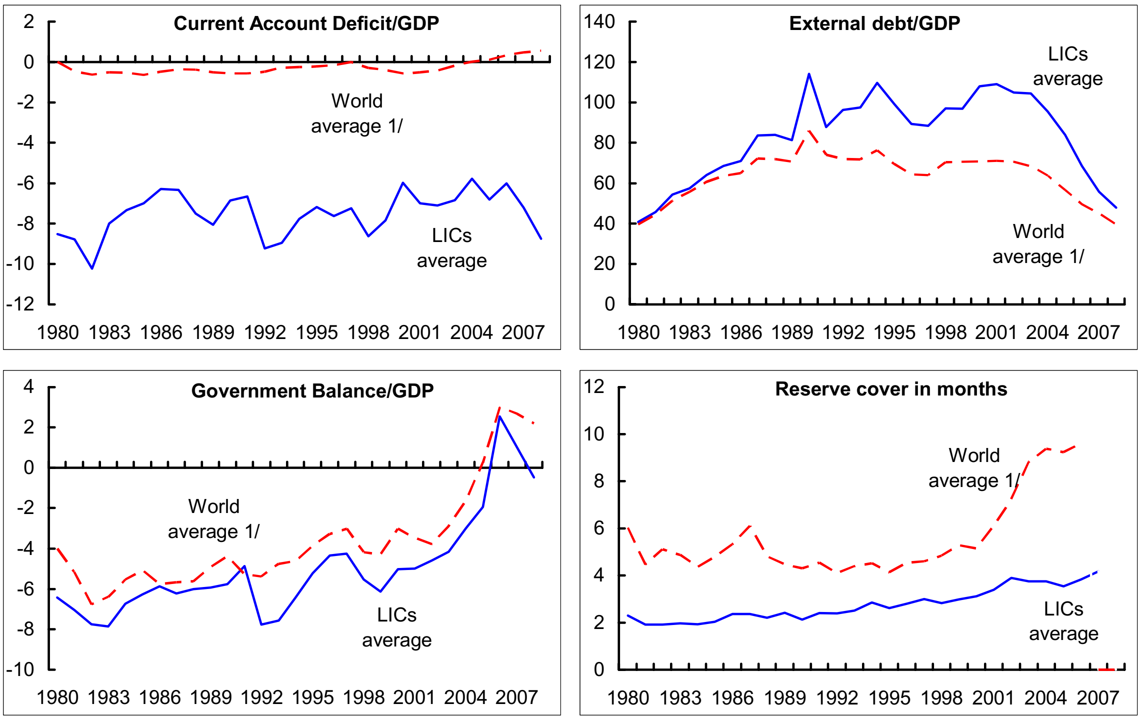
2/ Including current transfers.

Table 2. Inflation Projections, Spring 2008, and Current Projection
(In percent, median)

	WEO Spring 2008		Latest Projections	
	2008	2009	2008	2009
All LICs	7.1	6.0	11.2	7.8
Sub-Saharan Africa	6.7	5.3	10.2	6.4
Asia	8.8	6.0	13.5	8.2
Middle East and Europe	10.3	7.9	14.4	8.7
Latin American countries	6.2	6.5	9.9	6.9
Net Oil importers	7.0	6.0	10.8	6.9
Net Oil exporters	8.3	7.3	11.8	8.2
Countries according to their per capita income	0.0	0.0	0.0	0.0
top 25%	6.0	4.5	9.0	4.5
mid 50%	8.5	6.1	12.0	7.9
bottom 25%	8.0	6.4	11.2	9.8

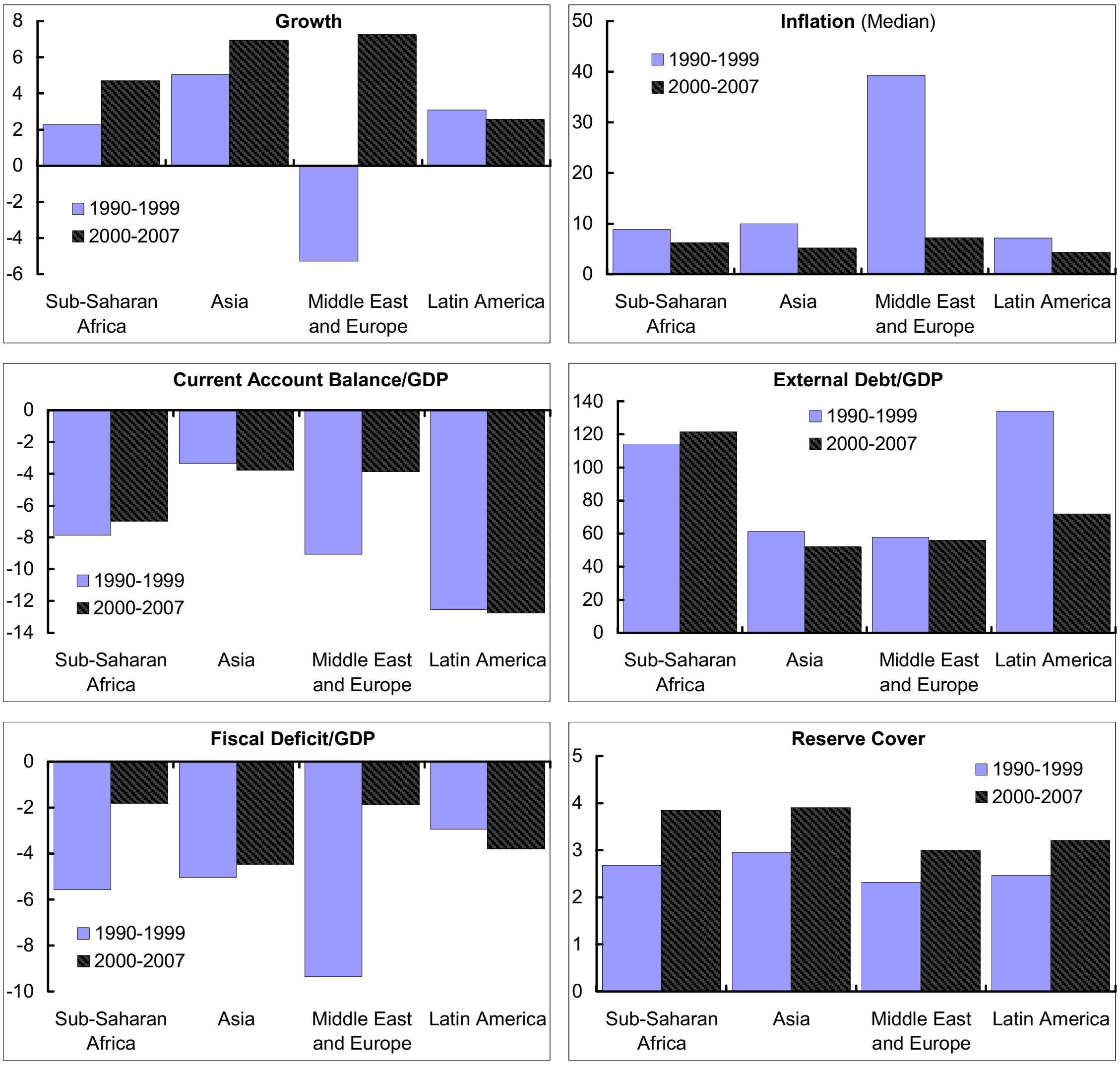
Sources: WEO database, and Fund staff calculations.

Figure 1. Selected Indicators; LICs versus the World, 1980-2008;1/ Current Projection



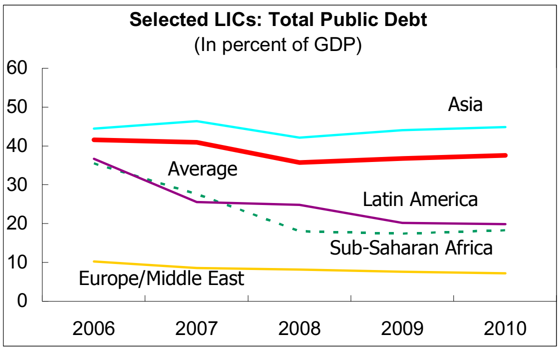
Sources: WEO, and World Bank WDI databases.
1. Emerging and developing countries.

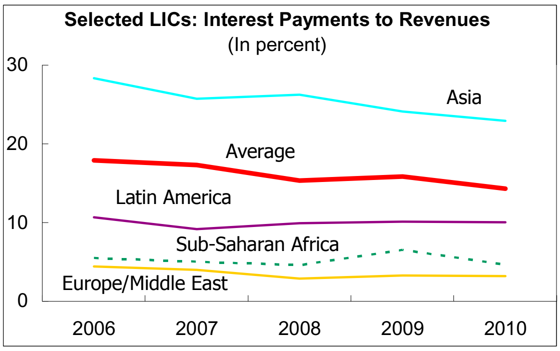
Figure 2. Selected Indicators; LICs by Regions
(Period averages, in percent, unless otherwise indicated)

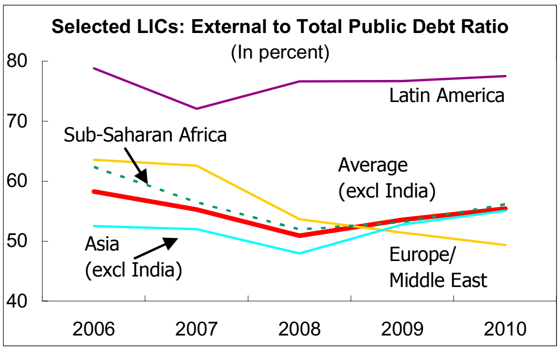


Sources: WEO database, and Fund staff calculations.

Appendix III. Selected Debt Indicators







Source: WEO database.

Appendix IV. Debt Simulations

The global slowdown could have potentially important implications for LIC debt sustainability. The magnitude of these implications is highly uncertain. Accordingly, this section presents the details on the simulation to analyze LICs' risk of debt distress. The debt simulations for 2009 assume reduced investment expenditure financing from aid, and FDI is replaced with public external borrowing (the reductions in aid and FDI in this simulation are identical to those in the simulations of Appendix V). Debt levels are measured relative to GDP and the corresponding debt service relative to exports. A country is considered at high risk of debt distress if these ratios exceed their corresponding thresholds.[34] In order to provide a broad range of results for each country, the simulations comprise two scenarios — one where new debt is contracted under nonconcessional terms and the other under concessional terms.[35]

The results of this appendix are for illustrative purposes only and should not be considered as actual debt projections at the country level. The final impact of the global slowdown is highly dependent on policy responses and domestic factors, as well as on the interaction of different shocks. In addition, the magnitude of the shocks to FDI and aid in the simulations, and consequently any public debt that replaces these financing sources, is not based on a projection of likely developments.

The risks to debt sustainability posed by the current financial crisis vary depending on initial conditions (Table 1). The debt simulations for 2009 assume that reduced investment expenditure financing from aid and FDI is replaced with public external borrowing. Relative to GDP, the simulated increase in public external borrowing during one year adds 4 percent of GDP to the average LIC debt burden. For countries with already high debt levels, this further raises risks of debt distress. Moreover for some of the poorest LICs, aid represents a large portion of GDP. Consequently, replacing public debt for a portion of that aid significantly increases their already high debt burden. A handful of countries that were previously on the verge of high risk of debt distress become so as a result of the simulation. At the same time, with few exceptions, LICs with sustainable debt prior to the crisis would continue to avoid high risk of debt distress.

The results also illustrate the importance of new borrowing being on concessional terms. The distinction between concessional and nonconcessional debt has an important impact on the debt service burden.

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[34]The thresholds are commensurate with those applied in World Bank/IMF debt sustainability analysis for LICs and are designed to correspond to the World Bank's Country Performance and Institutional Assessment ratings.

[35]Commercial interest rates are assumed to be 8 percent, consistent with the World Bank/IMF debt sustainability analysis assumptions, and concessional rates are assumed to be on IDA terms.

Appendix IV. Table 1. Debt Implications 1/

	Debt in percent of GDP				Debt Service in percent of Exports of Goods and Services				High Risk of Debt Distress Measured by Debt/GDP			High Risk of Debt Distress Measured by Debt Service/Exports		
	2008 proj.	2009 proj.	2009 simul.		2008 proj.	2009 proj.	2009 simul.		2008 proj.	2009 simul.		2008 proj.	2009 simul.	
			Conc. 2/	Non-Conc. 2/			Conc. 2/	Non-Conc. 2/		Conc. 2/	Non-Conc. 2/		Conc. 2/	Non-Conc. 2/
Afghanistan, I.R. of	.	.	.	.	.	.	.	.						
Albania	17	18	19	19	8	9	9	10						
Angola	10	15	13	13	3	6	6	7						
Armenia	14	16	16	16	2	3	3	4						
Azerbaijan	6	10	6	6	1	2	2	2						
Bangladesh	24	24	25	25	5	5	5	5						
Benin	12	14	16	16	5	5	5	7						
Bhutan	65	64	69	69	15	15	15	16	1	1	1			
Bolivia	19	21	20	20	6	9	9	10						
Burkina Faso	19	22	22	22	6	5	5	8						
Burundi	127	27	132	132	3	2	2	7	1	1	1			
Cambodia	26	26	31	31	0	1	1	1		1	1			
Cameroon	6	8	7	7	8	10	10	10						
Cape Verde	55	56	61	61	8	7	7	8	1	1	1			
Central African Rep.	50	50	52	52	9	11	11	12	1	1	1			
Chad	19	24	23	23	3	4	4	5						
Comoros	47	48	50	50	13	10	11	12	1	1	1			
Congo, Dem. Rep. of	87	23	93	93	4	7	7	9	1	1	1			
Congo, Republic of	50	68	57	57	5	6	6	7	1	1	1			
Côte d'Ivoire	83	80	84	84	9	12	12	12	1	1	1			
Djibouti	64	65	76	76	7	13	13	15	1	1	1			
Dominica	59	56	68	68	-26	-24	-24	-22	1	1	1			
Eritrea	59	57	61	61	25	24	24	25	1	1	1	1	1	1
Ethiopia	11	14	14	14	1	3	3	5						
Gambia, The	44	46	47	47	24	24	24	25	1	1	1	1	1	1
Georgia	34	39	39	39	15	24	24	25						1
Ghana	37	42	41	41	3	3	3	4						
Grenada	78	77	86	86	15	18	18	20	1	1	1			
Guinea	67	21	69	69	20	10	10	11	1	1	1	1		
Guinea-Bissau	235	224	243	243	11	427	427	429	1	1	1		1	1
Guyana	80	89	89	89	0	1	1	1	1	1	1			
Haiti	23	26	27	27	6	9	9	11						
Honduras	17	16	20	20	2	2	2	2						
India	19	19	19	19	7	7	7	7						
Kenya	19	19	20	20	5	4	4	4						
Kyrgyz Republic	52	49	55	55	3	4	4	5	1	1	1			
Lao People's Dem. Rep.	98	104	105	105	14	16	17	18	1	1	1		1	1
Lesotho	39	38	52	52	3	5	5	7		1	1			
Liberia	475	468	490	490	0	0	0	4						
Madagascar	25	29	30	30	2	4	4	5						
Malawi	17	18	22	22	4	4	4	5						
Maldives	83	92	90	90	9	10	10	10	1	1	1			
Mali	22	25	23	23	3	4	4	4						
Mauritania	57	60	60	60	.	.	.	.	1	1	1			
Moldova	44	49	48	48	14	15	15	15	1	1	1			
Mongolia	35	47	40	40	3	4	4	5						
Mozambique	52	52	66	66	19	28	29	33	1	1	1		1	1
Myanmar	28	27	28	28	3	4	4	4						
Nepal	28	29	29	29	9	9	9	10						
Nicaragua	69	54	75	75	10	9	9	10	1	1	1			
Niger	14	17	19	19	12	11	11	13						
Nigeria	2	3	3	3	2	3	3	4						
Pakistan	27	32	28	28	14	12	13	13						
Papua New Guinea	20	18	21	21	6	8	8	8						
Rwanda	15	15	21	21	3	2	3	7						
São Tomé & Príncipe	70	50	88	88	.	.	.	.	1	1	1			
Senegal	38	44	41	41	5	8	8	9		1	1			
Sierra Leone	17	16	20	20	1	2	2	3						
Somalia	.	.	.	.	.	.	.	.						
Sri Lanka	43	42	44	44	.	.	.	.	1	1	1			
St. Lucia	44	46	49	49	8	8	8	9						
St. Vincent & Grens.	0	.	7	7	16	18	18	20						
Sudan	58	65	61	61	4	11	11	13	1	1	1			
Tajikistan	45	46	46	46	86	32	32	33	1	1	1	1	1	1
Tanzania	34	34	38	38	1	1	2	3						
Togo	64	62	66	66	2	4	4	4	1	1	1			
Uganda	13	15	16	16	3	3	3	4						
Uzbekistan	14	13	14	14	6	7	7	7						
Vietnam	30	33	37	37	3	5	5	6						
Yemen, Republic of	22	22	23	23	2	3	3	4						
Zambia	6	7	8	8	1	2	2	3						
All LICs	48	46	52	52	8	14	14	15	28	31	31	4	6	7
SSA	55	50	60	60	6	18	18	20	15	17	17	3	4	4
Asia	37	40	40	40	6	7	7	7	4	5	5	0	1	1
Middle East/Europe	31	33	34	34	12	10	10	11	5	5	5	1	1	2
Latin America	43	43	49	49	4	5	5	7	4	4	4	0	0	0
Net oil importers	52	51	57	57	8	16	16	18	22	25	25	4	6	7
Net oil exporters	33	32	36	36	5	7	7	8	6	6	6	0	0	0
Countries with top 25% per capita income	41	47	45	45	5	7	7	8	8	8	8	0	0	1
Countries with mid 50% per capita income	37	36	40	40	9	8	8	9	13	16	16	2	2	2
Countries with bottom 25% per capita income	77	67	82	82	7	33	33	35	7	7	7	2	4	4

1/ Reduced FDI and aid, relative to 2008, are assumed to be fully replaced by external debt (private and public) value to obtain 2009 simulations.
FDI and aid are each reduced by 30 percent of their 2008 value to obtain 2009 simulations.
2/ Conc. (non-conc) indicates the scenario with concessional (non-concessional) borrowing in 2009.
Sources: WEO database, and Fund staff calculations.

Appendix V. Simulation Results

While the global slowdown is spreading worldwide, LICs are expected to witness serious macroeconomic effects, with important balance of payments repercussions. The magnitude of these repercussions is highly uncertain. Accordingly, this section presents an overall assessment of the LICs' short-run vulnerabilities to the global downturn, incorporating in part LIC vulnerabilities resulting from a combination of simulated shocks. The details of various simulation channels to analyze LICs' short-run balance of payments vulnerabilities to the global downturn are also presented. The balance of payments simulations relate to the channels highlighted in the second part of Section IV. The simulation exercises of possible shocks to trade, remittances, FDI, and aid presented here are consistent with the methodology applied to the analysis of the food and fuel price shocks in IMF (2008b).

The overall vulnerability assessment for LICs analyzes LICs' short-run vulnerabilities to the global downturn on the basis of both its effects in the current baseline projections and the simulation exercise. The current baseline projections used in this exercise are for real GDP growth and reserves in months of imports.[36] The simulation is a simple partial equilibrium exercise to assess the immediate impact on the balance of payments and reserves of the assumed shocks: the trade balance (as a result of lower world market prices and export volumes), remittances, FDI, and aid. The exercises do not incorporate further effects on growth or demand. The overall vulnerability assessment ranks countries in three vulnerability categories—high (H), medium (M), or low (L). A country is considered to have high overall vulnerability when the current baseline projects a sizable decline in real GDP growth and reserves in conjunction with significant vulnerability in the shock simulation.[37] For the shock simulation and each of its individual channels, countries are also ranked in three vulnerability categories—high (H), medium (M), or low (L)—depending on the impact of these shocks expressed in terms of the import coverage of reserves. The H category encompasses countries that had a reserve coverage of less than three months of imports in 2008 and could lose more than an extra 0.5 month in the shock scenario.[38] While three months of import coverage is a standard benchmark, actual vulnerabilities depend on a range of factors, in particular the

[36]In these exercises, reserve coverage is measured in terms of current year imports rather than the following year imports (the regular measure), as the latter would have required assumptions on import in 2010, and thus on the permanency and growth effects of the shocks, which goes beyond the scope of this paper.

[37]A reduction in excess of 2.5 percent of GDP is considered a large reduction in projected real GDP. A moderate decline in real GDP could correspond to a 0.5 percent drop. A large reduction in reserves in months of imports is a decline in excess of 0.5 month of imports. Any reduction below this would be considered moderate.

[38]Countries in the M category either start with more than 3 months of export coverage and lose more than 0.5 in the shock, or start below 3 months of coverage and lose less than 0.5 month with the shock. In the L bracket, countries start with more than 3 months of import coverage and lose less than 0.5 in the shock scenario. For members of the CFA zone, the weight of reserves adequacy was reduced.

exchange rate regime. Accordingly, the simple methodology presented here offers only a crude approximation of the country-specific vulnerabilities.

Stressing the limitations of the partial analysis conducted here, the results of this appendix should not be considered as actual projections at the country level. The final impact of the global slowdown is highly dependent on policy responses and domestic factors, as well as on the interaction of different shocks. In addition, the magnitude of the shocks in the simulations is not based on a projection of likely developments. Therefore, the results presented in this appendix should be considered only for illustrative purposes.

Overall Vulnerability

About 30 percent of LICs could be considered highly vulnerable to the consequences of global financial crisis (Table 1). About 50 percent of these highly vulnerable countries are in sub-Saharan Africa (SSA). The majority of the highly vulnerable countries face sizable declines in projected GDP, some in excess of 5 percent. About 60 percent of the countries are also found to be highly vulnerable to the simulated shock. More than half of the countries with high vulnerabilities resulting from the simulated shock are also in SSA (Table 2). Details on the individual channels that comprise the shock to the balance of payments are provided in the remainder of this appendix.

Trade

The analysis of the potential impact of the trade channel is summarized in one shock combining several commodities' shock simulations together and in an alternative trade shock resulting from increased oil prices. In the combined shock, the commodities are oil, other commodities, food, other exports, and services exports. The shock simulations are a partial equilibrium exercise and the impact of all shocks affects exports through prices or volumes. The oil, other commodities, and food shocks are channeled through a decrease in international prices. The shock simulates a return of the prices from their average 2008 levels to their 1995–2007 averages. For manufactured exports and services, the impact of the crisis is expected to be channeled through a decrease in volumes. LICs are assumed to be price takers and the estimated drop in value as a result of the shock can be attributed entirely to the drop in the volume of exports resulting from lower global demand. The shocks are simulated as a 10 percent drop in the value of exports in line with an assumed drop in demand in trading partners. In LICs exports of services largely fall into two categories: transportation (e.g., for countries with an active port that act as regional hubs) and tourism. Tourism receipts are expected to be significant only in a handful of LICs, while the majority of services receipts are in the transport sector, i.e., trade-related.

The combined trade shock (Table 3) points to the vulnerability of LICs in our sample to the trade channel, where about a fifth of all countries were found to be highly vulnerable. The overall vulnerability seems to reflect regional concentration in Africa, where over 40 percent of the countries fall in the highly vulnerable group, and the country's per capita income. Operating a fixed exchange rate regime seems to contribute to a country's vulnerability, where a larger portion of LICs in that category (39 percent) appear to be highly vulnerable compared with the floaters (29 percent).

The simulation of an increase in oil prices (Table 4) shifts most of the countries in our sample from the low-vulnerability category into that of high vulnerability, where about 60 percent of LICs would fall. In this scenario, LICs in all regions are highly vulnerable, particularly oil importers. Contrary to the scenario where oil prices drop to historical average, the exchange rate arrangement does not appear to insulate the country from the impact of an increase in oil prices, where fixers and floaters appear equally vulnerable. The lowest per capita income category would be the hardest hit as over 70 percent of them become highly vulnerable.

Technical Summary

Combined Trade Shock

This combined trade shock adds all the below-mentioned shocks, including a decrease in international oil prices.

- Oil Price Decrease: The shock simulates a return of the prices from their average 2008 levels (US$97 per barrel) to their 1995–2007 average (US$32.5 per barrel).
- Food Price Shock: The shock simulates a drop in food commodity prices from their 2008 level to their 1995–2007 average level, about 35 percent on average. Consistent estimates of food imports/exports for all LICs are not directly available. Therefore, values of individual food commodity imports/exports for 2002–04[39] are extrapolated using the change in each individual commodity price and real GDP growth to estimate food imports/exports in 2008. This methodology suffers shortcomings because it assumes commodity volumes are a linear function of GDP growth. However, it ensures a consistent definition of food imports across countries.[40]
- Non-oil, Non-food Commodities Shock[41]: The shock simulates a drop in commodity prices from their 2008 level to their 1995–2007 average level, about 52 percent lower

[39]Computed by the IMF's Research Department based on WITS and desk data for the terms of trade exercise.

[40]Note that food imports can be defined in many ways. This paper looks at food commodity imports and excludes processed or industrial food since the consumption of such products is likely to be small in LICs. The following commodities are included in our food definition: bananas, barley, beef, fish, fishmeal, groundnuts, lamb, maize, olive oil, oranges, palm oil, poultry, rapeseed oil, rice, shrimp, soy meal, soy oil, soybeans, sugar, sunflower/safflower oil, pork, and wheat.

[41]Other commodities comprises coffee, cocoa, tea, hardwood log, hardwood sawn, softwood log, softwood sawn, cotton, wool, natural rubber, hides, aluminum, copper, lead, tin, zinc, iron, nickel, uranium, gold, natural gas, and coal.

on average. As for food imports/exports, we estimate non-oil commodity exports by extrapolating their 2002–04 values by the change in each individual commodity price and real GDP growth.

- Drop in Other Exports: Other exports (non-food, non-commodity exports) include manufactured products. The shock simulates a 10 percent drop in value.
- Services Shock: The shock simulates a 10 percent drop in value.
- Total Trade Shock. The total trade shock adds all the above-mentioned shocks, including a *decrease* in international oil prices.

Oil Price Increase

The shock simulates a 25 percent increase in oil prices from their average 2008 level (US$97 per barrel), to about US$125 per barrel.

Remittances

The shock of a sudden reduction in remittances is calibrated for each region, and takes into account both direct and indirect effects on the balance of payments. For each region, the shock was calibrated as half of the decline that is necessary to reduce 2009 remittances to the average remittances during 2000–05. Then, within regions, the shock was applied uniformly to all countries. This implied a reduction of 36 percent for African LICs, 25 percent for Asian LICs, 24 percent for European LICs, 28 percent for Middle East/Europe LICs, and 30 percent for Latin America LICs. By considering only half of the decline, instead of the total decline, the proposed methodology acknowledges that a reduction in remittances will not only lead to a direct worsening of the balance of payments and hence reserves, but also to an indirect improvement as remittances-related imports might decline.

The simulations reveal that around 50 percent of LICs could face a vulnerable balance of payments situation as a result of a sudden decline in remittances (Table 5). Across regions, Latin America would be most severely impacted, where almost 90 percent of LICs would have reserves under 3 months of imports. In the rest of the regions, except for Africa, 20 percent of the countries would have reserves under 3 months of imports. In Africa, almost 50 percent of the countries could be vulnerable under this metric. Out of all LICs in our sample, just 20 percent of them would lose reserves in excess of half a month worth of imports.

FDI

A sudden reduction in FDI is assumed to have both direct and indirect effects on the balance of payments. The FDI simulations entail a shock reducing 2009 FDI to the average FDI during 2000–05, equivalent to a 30 percent reduction in 2008 FDI. The shock was applied uniformly to all LICs in our sample. Given that a significant portion of FDI is often spent on imports, imports were also assumed to decline.[42] Consequently, the balance of payments, and hence reserves, were worsened by the nominal amount of the FDI reduction and improved by the FDI-related import reduction.

Over 50 percent of LICs could face a vulnerable balance of payments situation resulting from suddenly reduced FDI—a consequence of global financial crisis (Table 6). LICs in Latin America would be most severely impacted, where almost 90 percent of them would have reserves under 3 months of imports. In the rest of the world, 60 percent of LICs would face reserves under 3 months of imports. About 10 percent of Asia's LICs would face a decline of over 0.5 month of imports.

Aid

A substantial decline in aid could result in a vulnerable balance of payments situation in over 50 percent of LICs (Table 7). The aid simulations for 2009 assume aid will be reduced by 30 percent relative to its 2008 value. This is equivalent to the average aid reduction for the three countries currently projecting the largest aid reductions for 2009. When aid is reduced by 30 percent, almost 90 percent of LICs in Latin America would have reserves under 3 months of imports. Meanwhile, 60 percent of LICs in the rest of the world would have reserves under 3 months of imports. Out of all LICs in our sample, over 40 percent of them would lose reserves in excess of half a month of imports.

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[42]The marginal propensity of FDI-related imported expenditure is assumed to be 0.5. Consequently FDI-related imports are expected to decline relative to FDI-imports of 2008. No such offset is included for the other shocks.

Appendix V. Table 1. Vulnerability Table

	Real GDP Growth	Reserves (in Months of Imports)	Vulnerability Score	
	2009 current less Spring WEO proj. 1/	2009 less 2008 2/	Simul. 3/ 4/	Overall Assessment 4/
Afghanistan, I.R. of	-0.7	0.3	H	M
Albania	-2.4	-0.7	M	H
Angola	-8.6	-1.0	M	H
Armenia	-5.0	-0.1	M	H
Azerbaijan	-7.6	1.2	M	M
Bangladesh	-1.2	0.0	M	M
Benin	-2.0	-0.6	L	M
Bhutan	-1.0	-0.2	L	L
Bolivia	-1.0	-0.7	L	L
Burkina Faso	-2.3	-0.6	M	M
Burundi	-2.0	-0.6	M	H
Cambodia	-2.2	-0.4	M	M
Cameroon	-1.1	-0.7	M	M
Cape Verde	-2.4	0.1	M	M
Central African Rep.	-2.0	-0.9	H	H
Chad	1.1	-2.1	M	M
Comoros	-2.2	-0.5	M	M
Congo, Dem. Rep. of	-7.3	0.6	H	H
Congo, Republic of	-0.3	-1.2	M	M
Côte d'Ivoire	-0.7	0.0	H	H
Djibouti	-1.5	0.2	H	H
Dominica	-1.5	0.1	M	M
Eritrea	-0.4	-0.1	M	M
Ethiopia	-0.6	0.6	H	M
Gambia, The	-0.5	-0.3	L	L
Georgia	-6.5	0.5	M	M
Ghana	-3.4	-1.2	M	H
Grenada	-3.4	0.2	M	M
Guinea	-1.1	0.5	H	M
Guinea-Bissau	0.0	0.7	M	L
Guyana	0.1	0.0	M	M
Haiti	-1.5	-0.3	H	H
Honduras	-2.6	-0.7	M	H
India	-2.8	-1.0	L	M
Kenya	-0.4	0.4	M	L
Kyrgyz Republic	-4.6	-0.1	M	H
Lao People's Dem. Rep.	-3.4	-0.9	M	H
Lesotho	-3.3	-0.8	M	H
Liberia	0.7	0.0	H	H
Madagascar	-2.2	0.5	M	M
Malawi	0.5	0.5	H	M
Maldives	2.5	0.8	M	L
Mali	-0.7	0.1	M	L
Mauritania	-2.8	-0.3	H	H
Moldova	-4.5	-0.2	M	H
Mongolia	-3.1	0.0	M	H
Mozambique	-1.5	-0.1	M	M
Myanmar	1.0	0.7	M	L
Nepal	0.1	0.0	M	L
Nicaragua	-2.7	0.1	M	M
Niger	0.0	-0.8	M	M
Nigeria	-5.0	-3.9	M	H
Pakistan	-4.7	0.4	M	M
Papua New Guinea	0.2	-0.9	H	H
Rwanda	0.4	-0.7	M	M
São Tomé & Príncipe	-0.5	-0.4	M	M
Senegal	-1.4	0.1	M	L
Sierra Leone	-1.5	-0.1	M	M
Somalia	.	.	.	.
Sri Lanka	-1.8	-0.2	M	M
St. Lucia	-5.4	-0.1	M	H
St. Vincent & Grens.	-4.7	-0.2	M	H
Sudan	-6.7	0.2	H	H
Tajikistan	-4.0	0.0	H	H
Tanzania	-2.7	0.1	M	M
Togo	-2.0	-0.3	M	M
Uganda	-1.0	-0.6	L	L
Uzbekistan	-0.5	0.8	L	L
Vietnam	-2.5	-0.9	M	H
Yemen, Republic of	-0.5	-1.6	L	L
Zambia	-2.4	0.2	H	H
All LICs	-2.1	-0.3	15 H 47 M 8 L	26 H 31 M 13 L
SSA	-1.8	-0.2	9 H 24 M 3 L	11 H 19 M 6 L
Asia	-1.4	-0.2	2 H 10 M 2 L	4 H 6 M 4 L
Middle East/Europe	-3.6	0.0	3 H 6 M 2 L	7 H 2 M 2 L
Latin America	-2.5	-0.2	1 H 7 M 1 L	4 H 4 M 1 L
Net oil importers	-1.9	-0.1	10 H 39 M 5 L	18 H 26 M 10 L
Net oil exporters	-2.8	-0.7	5 H 8 M 3 L	8 H 5 M 3 L
Countries with top 25% per capita income	-3.2	-0.1	0 H 16 M 1 L	7 H 8 M 2 L
Countries with mid 50% per capita income	-2.2	-0.5	10 H 20 M 5 L	16 H 13 M 6 L
Countries with bottom 25% per capita income	-0.9	0.0	5 H 11 M 2 L	3 H 10 M 5 L

1/ Current projection for 2009 less Spring WEO projection for 2009
2/ Current projection for 2009 less 2008 actual.
3/ Combined Shock: Trade, Remittances, Aid, FDI. See section IV for description of shocks and Appendix V tables for magnitudes of individual shocks.
4/ H = High risk; M=Medium risk; L=Low risk.
Sources: WEO database, and Fund staff calculations.

Appendix V. Table 2. Simulations' Vulnerability Table 1/

	Shocks: Vulnerability Ratings				Total Vulnerability Score 2/		
	Trade	FDI	Aid	Remittances			
Afghanistan, I.R. of	M	L	H	H		H	
Albania	L	L	L	M		M	
Angola	H	L	L	L		M	
Armenia	L	L	L	H		M	
Azerbaijan	H	L	L	L		M	
Bangladesh	L	M	M	H		M	
Benin	L	L	L	L		L	
Bhutan	L	L	L	L		L	
Bolivia	L	L	L	L		L	
Burkina Faso	L	L	M	L		M	
Burundi	L	L	H	L		M	
Cambodia	L	M	M	M		M	
Cameroon	H	L	L	L		M	
Cape Verde	L	M	H	M		M	
Central African Rep.	H	M	M	M		H	
Chad	H	L	L	L		M	
Comoros	L	L	M	M		M	
Congo, Dem. Rep. of	H	M	M	M		H	
Congo, Republic of	H	L	L	L		M	
Côte d'Ivoire	H	M	M	M		H	
Djibouti	M	H	M	M		H	
Dominica	L	M	H	M		M	
Eritrea	L	M	M	H		M	
Ethiopia	M	M	H	M		H	
Gambia, The	L	L	L	L		L	
Georgia	M	M	M	M		M	
Ghana	M	M	M	M		M	
Grenada	L	M	M	M		M	
Guinea	H	M	M	H		H	
Guinea-Bissau	L	L	M	M		M	
Guyana	L	M	M	H		M	
Haiti	L	L	H	H		H	
Honduras	L	M	M	H		M	
India	L	L	L	L		L	
Kenya	L	M	M	M		M	
Kyrgyz Republic	L	L	L	H		M	
Lao People's Dem. Rep.	L	H	M	M		M	
Lesotho	L	L	M	L		M	
Liberia	H	M	M	H		H	
Madagascar	L	M	H	M		M	
Malawi	M	M	H	M		H	
Maldives	L	M	M	M		M	
Mali	M	L	L	L		M	
Mauritania	H	M	M	M		H	
Moldova	L	L	L	H		M	
Mongolia	M	M	M	M		M	
Mozambique	L	L	H	L		M	
Myanmar	M	L	L	L		M	
Nepal	L	L	L	M		M	
Nicaragua	L	M	M	H		M	
Niger	M	L	M	L		M	
Nigeria	M	L	L	L		M	
Pakistan	L	M	M	M		M	
Papua New Guinea	H	L	L	L		H	
Rwanda	L	L	M	L		M	
São Tomé & Príncipe	L	L	M	L		M	
Senegal	L	M	M	H		M	
Sierra Leone	L	L	H	L		M	
Somalia	.	.	.	.		.	
Sri Lanka	M	M	M	M		M	
St. Lucia	M	M	M	M		M	
St. Vincent & Grens.	M	M	M	M		M	
Sudan	H	M	H	H		H	
Tajikistan	M	M	M	H		H	
Tanzania	L	L	M	L		M	
Togo	L	L	M	H		M	
Uganda	L	L	L	L		L	
Uzbekistan	L	L	L	L		L	
Vietnam	H	L	M	L		M	
Yemen, Republic of	L	L	L	L		L	
Zambia	H	M	M	M		H	
All LICs	M	M	M	M	15 H	47 M	8 L
SSA	M	L	M	M	9 H	24 M	3 L
Asia	M	M	M	M	2 H	10 M	2 L
Middle East/Europe	M	L	L	M	3 H	6 M	2 L
Latin America	L	M	M	M	1 H	7 M	1 L
Net oil importers	L	M	M	M	10 H	39 M	5 L
Net oil exporters	M	L	L	L	5 H	8 M	3 L
Fixed XR	M	L	M	M	5 H	29 M	5 L
Flexible XR	M	M	M	M	9 H	18 M	3 L
Countries with top 25% per capita income	M	M	M	M	0 H	16 M	1 L
Countries with mid 50% per capita income	M	M	M	M	10 H	20 M	5 L
Countries with bottom 25% per capita income	M	L	M	M	5 H	11 M	2 L

1/ H = High risk; M=Medium risk; L=Low risk.
2/ The total vulnerability score combines the ratings for each of the four simulated shocks, placing equal weight on each shock.
Sources: WEO database, and Fund staff calculations.

Appendix V. Table 3: Combined Trade Shock 1/

	Current Account in percent of GDP			Int. Reserves in Months of Imports of G&S		Vulnerable (IR<3)	Vulnerable (IR drop >0.5)	Vulnerability		
	2008 proj.	2009 proj.	2009 simul.	2008 proj.	2009 simul.	2009 simul.	2009 simul.	2009 simul.		
Afghanistan, I.S. of	-2.8	-2.3	-4.6	3.2	2.9	1			M	
Albania	-10.0	-7.5	-8.5	4.2	4.9				L	
Angola	5.8	1.3	-71.0	4.1	-10.2	1	1		H	
Armenia	-13.7	-12.9	-14.8	3.3	3.1				L	
Azerbaijan	30.9	10.9	-15.1	6.4	-12.5	1	1		H	
Bangladesh	0.7	0.5	1.6	3.0	3.7				L	
Benin	-9.6	-8.3	-6.7	7.3	10.0				L	
Bhutan	11.7	2.8	9.2	13.3	13.4				L	
Bolivia	11.0	-4.3	5.6	15.7	13.9		1		L	
Burkina Faso	-11.3	-9.5	-8.3	5.5	7.9				L	
Burundi	-12.5	-8.0	-10.7	3.7	4.7				L	
Cambodia	-11.9	-7.1	-5.4	3.0	4.7				L	
Cameroon	0.4	-5.4	-10.0	6.5	2.7	1	1		H	
Cape Verde	-13.0	-12.7	-12.6	3.0	3.3				L	
Central African Rep.	-8.7	-7.2	-13.7	2.9	0.6	1	1		H	
Chad	-9.5	-19.6	-56.5	4.6	-2.8	1	1		H	
Comoros	-8.7	-8.3	-2.5	6.0	9.6				L	
Congo, Dem. Rep. of	-12.4	-19.8	-18.6	0.5	-0.3	1	1		H	
Congo, Republic of	-0.8	-18.1	-69.8	7.2	0.3	1	1		H	
Côte d'Ivoire	0.1	-2.6	-11.6	2.5	-0.2	1	1		H	
Djibouti	-38.2	-14.0	-35.2	2.2	2.7	1			M	
Dominica	-30.1	-24.4	-27.7	2.9	3.6				L	
Eritrea	-2.7	1.1	4.2	0.9	4.9				L	
Ethiopia	-5.8	-5.9	-3.4	1.3	2.5	1			M	
Gambia, The	-13.9	-12.5	-13.7	4.8	5.2				L	
Georgia	-21.8	-17.7	-21.1	2.2	2.5	1			M	
Ghana	-20.2	-15.9	-19.2	1.6	2.0	1			M	
Grenada	-31.8	-31.8	-27.7	3.0	4.0				L	
Guinea	-4.1	-2.6	-9.3	1.3	-0.2	1	1		H	
Guinea-Bissau	0.2	-11.6	7.3	6.0	9.7				L	
Guyana	-20.8	-18.1	-23.9	2.8	3.1				L	
Haiti	-2.6	-4.4	2.7	3.2	5.9				L	
Honduras	-13.3	-8.3	-11.1	2.7	3.3				L	
India	-2.5	-1.8	-2.2	9.4	10.7				L	
Kenya	-6.6	-2.7	-2.4	2.9	5.0				L	
Kyrgyz Republic	-6.0	-6.5	-7.0	3.2	3.6				L	
Lao People's Dem. Re	-15.1	-11.9	-15.2	3.0	3.3				L	
Lesotho	-3.7	-8.5	-1.4	6.3	7.1				L	
Liberia	-31.8	-42.2	-50.8	0.7	0.2	1	1		H	
Madagascar	-22.6	-14.8	-20.0	2.3	3.1				L	
Malawi	-8.0	-4.6	-5.6	0.9	1.6	1			M	
Maldives	-46.0	-30.1	-33.1	2.7	4.4				L	
Mali	-6.1	-6.2	-10.1	4.6	4.0		1		M	
Mauritania	-6.1	-8.6	-77.8	0.9	-6.2	1	1		H	
Moldova	-18.9	-19.2	-17.1	3.3	3.8				L	
Mongolia	-9.2	-7.1	-10.5	1.9	2.1	1			M	
Mozambique	-12.7	-11.8	-13.0	4.8	5.4				L	
Myanmar	3.3	1.3	0.0	6.3	4.7		1		M	
Nepal	2.6	3.3	4.4	7.4	9.1				L	
Nicaragua	-23.6	-17.7	-18.9	2.5	3.4				L	
Niger	-9.9	-22.6	-14.8	5.6	4.7		1		M	
Nigeria	5.0	-10.7	-16.1	12.8	5.2		1		M	
Pakistan	-8.4	-4.7	-6.2	2.2	3.5				L	
Papua New Guinea	3.2	-5.5	-46.2	5.1	-1.5	1	1		H	
Rwanda	-6.9	-7.6	-5.3	5.9	7.3				L	
São Tomé & Príncipe	-34.0	-43.0	-24.0	5.5	7.9				L	
Senegal	-12.4	-10.4	-9.5	3.1	4.2				L	
Sierra Leone	-6.8	-4.5	-1.6	3.5	7.9				L	
Somalia	.	.	.	.	.				.	
Sri Lanka	-7.7	-5.9	-5.1	1.2	2.1	1			M	
St. Lucia	-29.5	-23.7	-29.6	2.2	2.3	1			M	
St. Vincent & Grens.	-34.1	-28.4	-34.1	2.4	2.6	1			M	
Sudan	-7.0	-10.0	-23.9	1.2	-6.6	1	1		H	
Tajikistan	-8.9	-8.6	-7.4	0.6	0.8	1			M	
Tanzania	-9.9	-8.6	-8.3	5.6	7.4				L	
Togo	-7.0	-6.4	4.6	3.1	7.2				L	
Uganda	-6.1	-7.9	-6.1	8.1	8.7				L	
Uzbekistan	13.5	7.3	5.3	10.6	7.7		1		L	
Vietnam	-10.3	-8.2	-20.3	3.6	2.5	1	1		H	
Yemen, Republic of	-2.1	-2.8	-16.8	10.2	6.3		1		L	
Zambia	-8.9	-8.3	-15.6	2.6	0.7	1	1		H	
All LICs	-9.6	-10.2	-15.2	4.3	3.6	26	22	15 H	15 M	40 L
SSA	-8.9	-11.0	-16.8	4.1	3.6	14	14	11 H	6 M	19 L
Asia	-6.6	-5.5	-9.5	4.7	4.7	5	3	2 H	4 M	8 L
Middle East/Europe	-6.4	-6.3	-13.6	4.5	1.8	5	4	2 H	3 M	6 L
Latin America	-19.4	-17.9	-18.3	4.1	4.7	2	1	0 H	2 M	7 L
Net oil importers	-12.7	-11.3	-11.5	3.7	4.6	15	7	4 H	14 M	36 L
Net oil exporters	0.8	-6.5	-27.8	6.1	0.5	11	15	11 H	1 M	4 L
Countries with top 25% per capita income	-13.7	-13.6	-23.9	3.8	1.9	8	3	3 H	5 M	9 L
Countries with mid 50% per capita income	-8.0	-8.7	-14.6	4.7	3.8	13	15	10 H	5 M	20 L
Countries with bottom 25% per capita income	-8.7	-9.8	-8.2	3.8	5.0	5.0	4	2 H	5 M	11 L

1/ The combined trade shock simulates for 2009 a return of commodities prices from their end-2008 levels to their 1995-2007 averages, and a 10 percent decline in the 2008 value of other exports and services.

Sources: WEO database, and Fund staff calculations.

Appendix V. Table 4: Combined Trade Shock, with a 25 percent Increase in Oil Prices 1/

	Current Account in percent of GDP			Int. Reserves in Months of Imports of G&S		Vulnerable (IR<3)	Vulnerable (IR drop >0.5)	Vulnerability		
	2008 proj.	2009 proj.	2009 simul.	2008 proj.	2009 simul.	2009 simul.	2009 simul.			
Afghanistan, I.R. of	-2.8	-2.3	-4.6	3.2	2.9	1			M	
Albania	-10.0	-7.5	-14.0	4.2	3.2		1		M	
Angola	5.8	1.3	41.4	4.1	9.6				L	
Armenia	-13.7	-12.9	-16.2	3.3	2.6	1	1		H	
Azerbaijan	30.9	10.9	75.3	6.4	13.3				L	
Bangladesh	0.7	0.5	-0.8	3.0	2.4	1	1		H	
Benin	-9.6	-8.3	-11.5	7.3	6.1		1		L	
Bhutan	11.7	2.8	4.9	13.3	11.4		1		L	
Bolivia	11.0	-4.3	4.6	15.7	13.2		1		L	
Burkina Faso	-11.3	-9.5	-13.0	5.5	4.4		1		M	
Burundi	-12.5	-8.0	-18.8	3.7	1.8	1	1		H	
Cambodia	-11.9	-7.1	-21.5	3.0	1.2	1	1		H	
Cameroon	0.4	-5.4	1.4	6.5	7.1				L	
Cape Verde	-13.0	-12.7	-18.6	3.0	2.0	1	1		H	
Central African Rep.	-8.7	-7.2	-8.8	2.9	3.1				L	
Chad	-9.5	-19.6	1.2	4.6	7.2				L	
Comoros	-8.7	-8.3	-7.5	6.0	6.8				L	
Congo, Dem. Rep. of	-12.4	-19.8	-18.5	0.5	-0.3	1	1		H	
Congo, Republic of	-0.8	-18.1	23.3	7.2	9.9				L	
Côte d'Ivoire	0.1	-2.6	-6.5	2.5	1.1	1	1		H	
Djibouti	-38.2	-14.0	-44.4	2.2	1.2	1	1		H	
Dominica	-30.1	-24.4	-36.6	2.9	1.6	1	1		H	
Eritrea	-2.7	1.1	-5.8	0.9	-0.4	1	1		H	
Ethiopia	-5.8	-5.9	-9.0	1.3	0.0	1	1		H	
Gambia, The	-13.9	-12.5	-18.2	4.8	3.7		1		M	
Georgia	-21.8	-17.7	-26.4	2.2	1.2	1	1		H	
Ghana	-20.2	-15.9	-31.0	1.6	-0.2	1	1		H	
Grenada	-31.8	-31.8	-37.0	3.0	1.8	1	1		H	
Guinea	-4.1	-2.6	-17.1	1.3	-2.4	1	1		H	
Guinea-Bissau	0.2	-11.6	-1.2	6.0	5.9				L	
Guyana	-20.8	-18.1	-56.0	2.8	-0.3	1	1		H	
Haiti	-2.6	-4.4	-4.7	3.2	2.5	1	1		H	
Honduras	-13.3	-8.3	-22.2	2.7	1.3	1	1		H	
India	-2.5	-1.8	-6.2	9.4	7.6		1		L	
Kenya	-6.6	-2.7	-11.3	2.9	1.3	1	1		H	
Kyrgyz Republic	-6.0	-6.5	-23.4	3.2	1.1	1	1		H	
Lao People's Dem. Rep.	-15.1	-11.9	-22.5	3.0	1.1	1	1		H	
Lesotho	-3.7	-8.5	-7.9	6.3	5.9				L	
Liberia	-31.8	-42.2	-67.4	0.7	-0.5	1	1		H	
Madagascar	-22.6	-14.8	-25.3	2.3	1.6	1	1		H	
Malawi	-8.0	-4.6	-11.7	0.9	-0.2	1	1		H	
Maldives	-46.0	-30.1	-55.9	2.7	1.1	1	1		H	
Mali	-6.1	-6.2	-17.6	4.6	0.7	1	1		H	
Mauritania	-6.1	-8.6	-38.1	0.9	-2.0	1	1		H	
Moldova	-18.9	-19.2	-26.2	3.3	2.3	1	1		H	
Mongolia	-9.2	-7.1	-29.4	1.9	-1.0	1	1		H	
Mozambique	-12.7	-11.8	-18.2	4.8	3.2		1		M	
Myanmar	3.3	1.3	0.0	6.3	4.7		1		M	
Nepal	2.6	3.3	0.3	7.4	6.4		1		L	
Nicaragua	-23.6	-17.7	-32.7	2.5	1.0	1	1		H	
Niger	-9.9	-22.6	-18.9	5.6	2.6	1	1		H	
Nigeria	5.0	-10.7	14.9	12.8	16.6				L	
Pakistan	-8.4	-4.7	-10.9	2.2	0.9	1	1		H	
Papua New Guinea	3.2	-5.5	-26.4	5.1	1.1	1	1		H	
Rwanda	-6.9	-7.6	-9.0	5.9	4.9		1		M	
São Tomé & Príncipe	-34.0	-43.0	-37.4	5.5	4.3		1		M	
Senegal	-12.4	-10.4	-14.1	3.1	2.5	1	1		H	
Sierra Leone	-6.8	-4.5	-10.9	3.5	1.5	1	1		H	
Somalia	.	.	.	.	.				.	
Sri Lanka	-7.7	-5.9	-12.0	1.2	-0.1	1	1		H	
St. Lucia	-29.5	-23.7	-37.3	2.2	1.0	1	1		H	
St. Vincent & Grens.	-34.1	-28.4	-41.9	2.4	1.0	1	1		H	
Sudan	-7.0	-10.0	-2.2	1.2	4.2				L	
Tajikistan	-8.9	-8.6	-14.4	0.6	-0.3	1	1		H	
Tanzania	-9.9	-8.6	-15.7	5.6	3.4		1		M	
Togo	-7.0	-6.4	-15.2	3.1	1.1	1	1		H	
Uganda	-6.1	-7.9	-9.6	8.1	6.6		1		L	
Uzbekistan	13.5	7.3	5.3	10.6	7.7		1		L	
Vietnam	-10.3	-8.2	-20.0	3.6	2.6	1	1		H	
Yemen, Republic of	-2.1	-2.8	4.5	10.2	13.0				L	
Zambia	-8.9	-8.3	-20.5	2.6	-0.8	1	1		H	
All LICs	-9.6	-10.2	-14.3	4.3	3.3	43	57	42 H	9 M	19 L
SSA	-8.9	-11.0	-12.6	4.1	3.3	19	27	19 H	6 M	11 L
Asia	-6.6	-5.5	-14.6	4.7	3.0	10	13	9 H	2 M	3 L
Middle East/Europe	-6.4	-6.3	-5.9	4.5	4.7	6	8	6 H	1 M	4 L
Latin America	-19.4	-17.9	-29.3	4.1	2.6	8	9	8 H	0 M	1 L
Net oil importers	-12.7	-11.3	-19.6	3.7	2.3	38	50	37 H	9 M	8 L
Net oil exporters	0.8	-6.5	3.3	6.1	6.9	5	7	5 H	0 M	11 L
Countries with top 25% per capita income	-13.7	-13.6	-15.2	3.8	3.5	1	14	12 H	1 M	4 L
Countries with mid 50% per capita income	-8.0	-8.7	-13.8	4.7	3.6	1	27	20 H	3 M	12 L
Countries with bottom 25% per capita income	-8.7	-9.8	-14.6	3.8	2.5	1	16	10 H	5 M	3 L

1/ The combined trade shock simulates for 2009 a 25 percent increase in oil prices, a return of commodities prices from their end-2008 levels to their 1995-2007 averages, and a 10 percent decline in the 2008 value of other exports and services.

Sources: WEO database, and Fund staff calculations.

Appendix V. Table 5. Reduced remittances 1/

	Remittances in percent of GDP			Int. Reserves in Months of Imports of G&S		Vulnerable (IR<3)	Vulnerable (IR drop >0.5)	Vulnerability Rating		
	2008 proj.	2009 proj.	2009 simul.	2009 proj.	2009 simul.	2009 simul.	2009 simul.	2009 simul.		
Afghanistan, I.R. of 3/	56.8	45.4	48.6	3.5	0.7	1	1		H	
Albania	11.5	9.1	9.0	4.4	3.6		1		M	
Angola	0.3	0.3	0.2	3.6	4.0				L	
Armenia 2/	11.0	.	8.1	3.8	2.4	1	1		H	
Azerbaijan	2.6	2.9	1.9	8.0	6.1				L	
Bangladesh	9.7	10.7	7.5	3.1	2.0	1	1		H	
Benin	3.1	3.0	2.0	7.2	6.8		1		L	
Bhutan 3/	-6.8	.	-6.8	13.9	13.3				L	
Bolivia	5.1	4.7	3.6	14.6	15.1		1		L	
Burkina Faso	0.8	0.9	0.5	6.1	5.4				L	
Burundi 3/	3.2	.	2.1	4.0	3.3				L	
Cambodia 2/	3.3	.	2.5	3.1	2.8	1			M	
Cameroon 2/	0.7	.	0.5	6.2	6.4				L	
Cape Verde	6.9	6.1	4.5	3.4	2.6	1			M	
Central African Rep.	-0.3	-0.3	-0.3	2.9	2.9	1			M	
Chad	2.6	3.1	1.7	3.6	4.4				L	
Comoros	21.2	20.8	14.6	6.8	3.9		1		M	
Congo, Dem. Rep. of	1.8	.	1.2	1.4	0.4	1			M	
Congo, Republic of	0.0	0.0	0.0	8.6	7.2				L	
Côte d'Ivoire	-2.6	-2.9	-2.6	3.1	2.5	1			M	
Djibouti	-4.0	-3.7	-4.0	3.8	2.2	1			M	
Dominica	8.0	8.0	5.7	3.1	2.5	1			M	
Eritrea 3/	20.7	.	14.3	1.1	-1.9	1	1		H	
Ethiopia 2/	1.4	.	0.9	1.8	1.1	1			M	
Gambia, The	1.1	1.1	0.7	4.5	4.7				L	
Georgia	5.7	5.7	4.2	3.4	1.9	1			M	
Ghana 2/	0.7	.	0.5	0.6	1.5	1			M	
Grenada	4.1	3.2	2.9	3.3	2.8	1			M	
Guinea	7.0	6.6	4.6	2.2	0.5	1	1		H	
Guinea-Bissau	7.5	6.0	4.9	7.1	5.4		1		M	
Guyana	26.8	21.1	20.4	3.2	2.0	1	1		H	
Haiti	19.3	16.0	14.3	2.9	1.5	1	1		H	
Honduras	19.4	15.9	14.3	2.5	1.8	1	1		H	
India 2/	2.5	.	1.9	9.4	9.2				L	
Kenya	3.3	3.2	2.1	4.0	2.5	1			M	
Kyrgyz Republic	27.9	21.0	21.8	3.8	2.3	1	1		H	
Lao People's Dem. Rep. 2/	0.0	.	0.0	2.6	3.0	1			M	
Lesotho	0.0	0.0	0.0	6.0	6.3				L	
Liberia 2/	86.5	.	80.4	0.7	-0.7	1	1		H	
Madagascar	0.3	0.2	0.2	3.2	2.3	1			M	
Malawi 2/	0.0	.	0.0	1.4	0.9	1			M	
Maldives 2/	0.2	.	0.2	3.6	2.7	1			M	
Mali 2/	2.5	.	1.6	5.3	4.2				L	
Mauritania	2.1	2.3	1.5	0.9	0.8	1			M	
Moldova	17.1	14.4	13.6	3.3	2.8	1	1		H	
Mongolia	1.7	1.3	1.3	2.6	1.8	1			M	
Mozambique 2/	1.0	.	0.7	4.9	4.7				L	
Myanmar 2/	0.6	.	0.4	6.9	6.2				L	
Nepal	16.4	16.9	12.9	7.7	5.9		1		M	
Nicaragua	12.9	11.8	9.4	3.0	1.9	1	1		H	
Niger 2/	1.5	.	1.0	3.7	5.4				L	
Nigeria	1.6	2.1	1.0	11.1	12.6				L	
Pakistan	4.0	4.4	2.9	2.8	1.7	1			M	
Papua New Guinea	0.5	0.1	0.4	5.2	5.1				L	
Rwanda	0.9	0.9	0.6	5.1	5.8				L	
São Tomé & Príncipe	1.7	1.9	1.1	3.8	5.4				L	
Senegal	8.2	6.8	5.4	4.0	2.3	1	1		H	
Sierra Leone	0.7	0.7	0.4	4.0	3.4				L	
Somalia	.	.	.	.	.				.	
Sri Lanka	7.4	7.0	5.7	1.3	0.7	1			M	
St. Lucia 2/	3.0	.	2.1	2.1	2.0	1			M	
St. Vincent & Grens.	2.8	2.7	2.0	2.6	2.2	1			M	
Sudan 2/	3.1	.	2.3	1.7	0.7	1	1		H	
Tajikistan	45.1	38.6	37.1	0.5	-1.3	1	1		H	
Tanzania 2/	0.1	.	0.0	5.8	5.6				L	
Togo	16.2	13.5	11.0	3.5	2.0	1	1		H	
Uganda 2/	6.0	.	3.9	7.2	7.2		1		L	
Uzbekistan 3/	7.6	3.8	5.6	13.0	9.9		1		L	
Vietnam 2/	6.1	.	4.7	4.1	3.4				L	
Yemen, Republic of	5.2	3.8	3.8	12.8	9.7		1		L	
Zambia 2/	0.4	.	0.3	3.4	2.6	1			M	
All LICs	7.8	7.4	6.0	4.5	3.8	39	25	16 H	27 M	27 L
SSA	5.8	2.1	4.5	4.2	3.7	15	9	5 H	12 M	18 L
Asia	7.3	6.1	5.9	5.0	4.2	6	2	1 H	6 M	5 L
Middle East/Europe	11.1	8.0	8.6	4.9	3.4	9	7	5 H	4 M	3 L
Latin America	11.3	9.3	8.3	4.1	3.5	8	5	4 H	4 M	1 L
Net oil importers	9.0	8.8	7.1	4.0	3.2	35	20	15 H	23 M	16 L
Net oil exporters	3.6	3.4	2.5	6.5	5.8	4	5	1 H	4 M	11 L
Countries with top 25% per capita income	6.2	6.4	4.4	4.3	3.5	12.0	4.0	3 H	10 M	4 L
Countries with mid 50% per capita income	6.2	6.9	4.6	4.9	4.2	19.0	14.0	9 H	11 M	15 L
Countries with bottom 25% per capita income	12.4	10.6	10.2	4.0	3.2	8.0	7.0	4 H	6 M	8 M

1/ Remittances are reduced by regionally calibrated amounts, averaging 34 percent, to obtain 2009 simulations.
2/ The projection of remittances for 2008 is from the World Bank (2008), since it was not available from Fund staff.
3/ As remittances data are not available, the projection for 2008 corresponds to private current transfers from World Economic Outlook.
Sources: WEO database, Fund staff calculations, and World Bank.

Appendix V. Table 6. Reduced FDI 1/

	FDI in percent of GDP			Int. Reserves in Months of Imports of G&S		Vulnerable (IR<3)	Vulnerable (IR drop >0.5)	Vulnerability Rating		
	2008 proj.	2009 proj.	2009 simul.	2008 proj.	2009 simul.	2009 simul.	2009 simul.	2009 simul.		
Afghanistan, I.R. of	2.4	3.2	1.7	3.2	3.1				L	
Albania	4.9	4.6	3.5	4.2	4.1				L	
Angola	9.5	.	6.8	4.1	3.7				L	
Armenia	6.6	6.2	4.7	3.3	3.1				L	
Azerbaijan	-4.1	-1.8	-4.1	6.4	6.4				L	
Bangladesh	0.8	0.8	0.6	3.0	3.0	1			M	
Benin	3.1	2.0	2.2	7.3	7.2				L	
Bhutan	0.9	0.9	0.7	13.3	13.3				L	
Bolivia	2.4	3.0	1.7	15.7	15.7				L	
Burkina Faso	2.2	1.0	1.5	5.5	5.4				L	
Burundi	0.0	0.0	0.0	3.7	3.7				L	
Cambodia	7.4	4.1	5.2	3.0	2.8	1			M	
Cameroon	1.7	2.8	1.2	6.5	6.4				L	
Cape Verde	9.8	7.8	7.0	3.0	2.8	1			M	
Central African Rep.	5.1	5.1	3.6	2.9	2.6	1			M	
Chad	14.3	9.9	10.2	4.6	4.3				L	
Comoros	1.6	1.5	1.1	6.0	6.0				L	
Congo, Dem. Rep. of	14.5	5.6	10.4	0.5	0.2	1			M	
Congo, Republic of	23.3	21.5	16.9	7.2	6.9				L	
Côte d'Ivoire	2.2	2.6	1.5	2.5	2.4	1			M	
Djibouti	31.4	9.8	23.0	2.2	1.6	1	1		H	
Dominica	14.3	12.1	10.2	2.9	2.6	1			M	
Eritrea	2.4	3.6	1.7	0.9	0.8	1			M	
Ethiopia	3.2	1.9	2.2	1.3	1.2	1			M	
Gambia, The	9.0	8.0	6.4	4.8	4.6				L	
Georgia	9.7	7.7	6.9	2.2	1.9	1			M	
Ghana	6.0	5.0	4.2	1.6	1.5	1			M	
Grenada	19.2	21.8	13.8	3.0	2.6	1			M	
Guinea	2.5	2.2	1.7	1.3	1.2	1			M	
Guinea-Bissau	2.9	2.8	2.0	6.0	6.0				L	
Guyana	13.4	11.4	9.6	2.8	2.6	1			M	
Haiti	0.4	0.3	0.3	3.2	3.2				L	
Honduras	7.4	4.0	5.2	2.7	2.6	1			M	
India	1.6	1.2	1.1	9.4	9.4				L	
Kenya	2.7	3.3	1.9	2.9	2.8	1			M	
Kyrgyz Republic	6.1	4.2	4.3	3.2	3.1				L	
Lao People's Dem. Rep.	18.5	16.5	13.3	3.0	2.4	1	1		H	
Lesotho	5.4	3.9	3.8	6.3	6.3				L	
Liberia	23.5	42.8	17.1	0.7	0.6	1			M	
Madagascar	7.6	2.7	5.4	2.3	2.1	1			M	
Malawi	5.2	2.9	3.7	0.9	0.7	1			M	
Maldives	20.5	18.5	14.8	2.7	2.5	1			M	
Mali	1.4	1.1	1.0	4.6	4.5				L	
Mauritania	2.0	4.1	1.4	0.9	0.9	1			M	
Moldova	11.1	9.5	7.9	3.3	3.2				L	
Mongolia	12.6	7.0	9.0	1.9	1.7	1			M	
Mozambique	4.7	4.7	3.3	4.8	4.6				L	
Myanmar	0.9	0.9	0.6	6.3	6.3				L	
Nepal	0.0	0.2	0.0	7.4	7.4				L	
Nicaragua	7.1	6.1	5.0	2.5	2.3	1			M	
Niger	8.1	13.4	5.7	5.6	5.4				L	
Nigeria	2.2	3.9	1.6	12.8	12.8				L	
Pakistan	3.0	2.1	2.1	2.2	2.0	1			M	
Papua New Guinea	1.4	1.3	0.9	5.1	5.1				L	
Rwanda	2.4	1.7	1.7	5.9	5.8				L	
São Tomé & Príncipe	33.5	11.4	24.7	5.5	5.0				L	
Senegal	4.5	3.8	3.2	3.1	3.0	1			M	
Sierra Leone	2.5	1.1	1.8	3.5	3.4				L	
Somalia	.	.	.	.	.				.	
Sri Lanka	1.5	0.6	1.0	1.2	1.1	1			M	
St. Lucia	17.5	20.3	12.6	2.2	1.8	1			M	
St. Vincent & Grens.	16.6	14.7	11.9	2.4	2.0	1			M	
Sudan	3.8	5.0	2.7	1.2	0.9	1			M	
Tajikistan	3.7	1.9	2.6	0.6	0.5	1			M	
Tanzania	3.5	3.9	2.5	5.6	5.5				L	
Togo	3.0	4.1	2.1	3.1	3.0				L	
Uganda	6.5	5.4	4.6	8.1	7.9				L	
Uzbekistan	2.7	2.9	1.9	10.6	10.6				L	
Vietnam	8.7	4.5	6.1	3.6	3.5				L	
Yemen, Republic of	1.8	0.8	1.2	10.2	10.2				L	
Zambia	4.4	1.9	3.1	2.6	2.4	1			M	
All LICs	7.0	5.9	5.0	4.3	4.1	33	2	2 H	31 M	37 L
SSA	6.6	5.5	4.7	4.1	4.0	14	0	0 H	15 M	21 L
Asia	5.7	4.4	4.1	4.7	4.5	6	1	1 H	6 M	7 L
Middle East/Europe	6.5	4.2	4.6	4.0	3.8	6	1	1 H	3 M	7 L
Latin America	10.9	10.4	7.8	4.1	3.9	7	0	0 H	7 M	2 L
Net oil importers	7.5	6.3	5.4	3.7	3.6	29	2	2 H	27 M	25 L
Net oil exporters	5.5	4.5	3.8	6.1	6.0	4	0	0 H	4 M	12 L
Countries with top 25% per capita income	10.8	9.8	7.7	3.8	3.6	11.0	0.0	0 H	11 M	6 L
Countries with mid 50% per capita income	6.0	4.1	4.3	4.7	4.6	16.0	2.0	2 H	14 M	19 L
Countries with bottom 25% per capita income	5.5	5.8	3.9	3.8	3.7	6.0	0.0	0 H	6 M	12 L

1/ FDI is reduced by 30 percent of its 2008 value to obtain 2009 simulations.
Sources: WEO database, and Fund staff calculations.

Appendix V. Table 7. Reduced Aid 1/

	Aid in percent of GDP			Int. Reserves in Months of Imports of G&S		Vulnerable (IR<3)	Vulnerable (IR drop >0.5)	Vulnerability Rating		
	2008 proj.	2009 proj.	2009 simul.	2008 proj.	2009 simul.	2009 simul.	2009 simul.	2009 simul.		
Afghanistan, I.R. of 2/	24.5	.	18.5	3.2	2.0	1	1		H	
Albania	2.7	2.2	1.9	4.2	4.0				L	
Angola 2/	0.1	.	0.1	4.1	4.0				L	
Armenia	0.5	.	0.4	3.3	3.2				L	
Azerbaijan	0.8	2.4	0.5	6.4	6.3				L	
Bangladesh	1.2	1.7	0.9	3.0	2.9	1			M	
Benin	8.3	7.4	6.0	7.3	6.2		1		L	
Bhutan	11.0	.	8.0	13.3	12.5		1		L	
Bolivia	1.2	1.1	0.9	15.7	15.5				L	
Burkina Faso	7.9	.	5.7	5.5	4.4		1		M	
Burundi	17.8	.	13.2	3.7	2.3	1	1		H	
Cambodia	6.4	6.4	4.6	3.0	2.7	1			M	
Cameroon	0.1	0.9	0.0	6.5	6.5				L	
Cape Verde	10.3	14.3	7.4	3.0	2.5	1	1		H	
Central African Rep.	2.2	1.9	1.6	2.9	2.6	1			M	
Chad	0.4	1.4	0.3	4.6	4.6				L	
Comoros	9.1	6.1	6.6	6.0	5.3		1		M	
Congo, Dem. Rep. of	6.4	.	4.6	0.5	0.2	1			M	
Congo, Republic of 2/	0.4	.	0.3	7.2	7.1				L	
Côte d'Ivoire	0.6	0.4	0.4	2.5	2.4	1			M	
Djibouti	10.0	10.2	7.2	2.2	1.8	1			M	
Dominica	14.0	13.1	10.3	2.9	2.2	1	1		H	
Eritrea	1.8	.	1.3	0.9	0.7	1			M	
Ethiopia	5.2	.	3.7	1.3	0.7	1	1		H	
Gambia, The	1.3	7.5	0.9	4.8	4.7				L	
Georgia	6.3	9.5	4.5	2.2	1.8	1			M	
Ghana	7.5	.	5.4	1.6	1.2	1			M	
Grenada	6.8	5.5	4.8	3.0	2.6	1			M	
Guinea	3.3	2.2	2.3	1.3	1.0	1			M	
Guinea-Bissau	21.4	20.8	16.0	6.0	4.6		1		M	
Guyana	17.6	18.2	13.0	2.8	2.3	1			M	
Haiti	10.5	8.0	7.6	3.2	2.3	1	1		H	
Honduras	3.2	2.2	2.3	2.7	2.5	1			M	
India	0.0	.	0.0	9.4	9.4				L	
Kenya	0.8	.	0.6	2.9	2.8	1			M	
Kyrgyz Republic	3.6	4.7	2.6	3.2	3.1				L	
Lao People's Dem. Rep.	4.5	.	3.2	3.0	2.7	1			M	
Lesotho	38.2	.	30.2	6.3	5.1		1		M	
Liberia 2/	26.6	.	20.3	0.7	0.4	1			M	
Madagascar	9.9	9.1	7.1	2.3	1.7	1	1		H	
Malawi	11.6	16.6	8.4	0.9	-0.1	1	1		H	
Maldives	2.7	.	1.9	2.7	2.6	1			M	
Mali	3.3	.	2.3	4.6	4.2				L	
Mauritania	8.5	9.3	6.1	0.9	0.5	1			M	
Moldova	1.5	2.4	1.0	3.3	3.3				L	
Mongolia	4.6	.	3.2	1.9	1.7	1			M	
Mozambique	42.8	.	34.3	4.8	1.1	1	1		H	
Myanmar	0.1	.	0.1	6.3	6.3				L	
Nepal	2.1	3.5	1.5	7.4	7.2				L	
Nicaragua	11.5	11.1	8.4	2.5	2.0	1			M	
Niger	7.4	12.0	5.3	5.6	4.8		1		M	
Nigeria 2/	0.7	.	0.5	12.8	12.7				L	
Pakistan	0.6	.	0.4	2.2	2.1	1			M	
Papua New Guinea	1.7	3.9	1.2	5.1	5.0				L	
Rwanda	17.6	16.0	13.0	5.9	3.8		1		M	
São Tomé & Príncipe	26.5	41.5	20.1	5.5	4.2		1		M	
Senegal	5.4	5.0	3.8	3.1	2.7	1			M	
Sierra Leone	6.3	6.3	4.5	3.5	2.7	1	1		H	
Somalia	.	.	.	.	.				.	
Sri Lanka	3.6	.	2.6	1.2	0.9	1			M	
St. Lucia	0.3	.	0.2	2.2	2.2	1			M	
St. Vincent & Grens.	5.3	6.0	3.8	2.4	2.1	1			M	
Sudan	4.8	.	3.4	1.2	0.4	1	1		H	
Tajikistan	1.8	.	1.3	0.6	0.5	1			M	
Tanzania	10.7	.	7.8	5.6	4.5		1		M	
Togo	2.1	3.5	1.5	3.1	3.0	1			M	
Uganda	4.9	.	3.5	8.1	7.5		1		L	
Uzbekistan	0.4	.	0.3	10.6	10.6				L	
Vietnam 2/	15.6	.	11.5	3.6	3.0		1		M	
Yemen, Republic of	1.1	2.0	0.7	10.2	10.1				L	
Zambia	4.5	6.0	3.2	2.6	2.2	1			M	
All LICs	7.3	7.7	5.4	4.3	3.8	39	23	11 H	37 M	22 L
SSA	9.2	5.2	6.9	4.1	3.5	18	17	7 H	20 M	9 L
Asia	5.6	1.1	4.1	4.7	4.4	6	2	1 H	8 M	5 L
Middle East/Europe	2.8	2.8	2.0	4.0	3.8	7	2	1 H	3 M	7 L
Latin America	7.8	7.2	5.7	4.1	3.7	8	2	2 H	6 M	1 L
Net oil importers	8.6	9.2	6.4	3.7	3.2	35	20	10 H	32 M	12 L
Net oil exporters	3.2	3.1	2.3	6.1	5.9	4	3	1 H	5 M	10 L
Countries with top 25% per capita income	5.3	8.2	3.8	3.8	3.6	11.0	3.0	2 H	9 M	6 L
Countries with mid 50% per capita income	6.1	6.4	4.5	4.7	4.3	17.0	9.0	2 H	21 M	12 L
Countries with bottom 25% per capita income	11.7	10.6	8.8	3.8	3.0	11.0	11.0	7 H	7 M	4 L

1/ Aid is reduced by 30 percent of its 2008 value to obtain 2009 simulations.
2/ Aid data for 2008 is estimated from the OECD Development Assistance Committee aid database.
Sources: WEO database, and Fund staff calculations.

Appendix VI. Scenarios for Financing Needs

This appendix shows various measures of LICs' financing needs due to the global crisis. The measures of the external shock and of the financing need focus on the change in balance of payments flows and reserves since the April 2008 WEO, in the most recent projections, and in a simulation of possible further shocks (see Appendix IV for details on the simulation, although here the combined shock does not include a shock to aid). For each case, and for all 70 LICs in the sample, the table shows reserves in U.S. dollars and in months of (current year's) imports of goods and services. The total magnitude of the shock or the financing need for all countries that are adversely affected is presented in the bottom part of the table.

The setup of the appendix table differs from that of the summary table in the main text. For both the most recent projections, and in a simulation of possible larger shocks, the table shows three results: The first column of the appendix table focuses on the total reserve loss and the resulting additional financing need. The second column focuses on the magnitude of the balance of payments shock before adjustment or import compression.

The first two columns of the appendix table show the change in 2009 reserves since the April 2008 WEO in U.S. dollars.

- As indicated at the bottom of the first column, the most recent projections show reduced projected reserves (in dollar terms) for 35 LICs (half of the sample). However, the very large overall revision, by US$131 billion, is largely explained by just two countries: Nigeria and India. 62 percent of the decline concerns the 16 oil producers in the sample. For 22 LICs, reserves are projected to fall below 3 months of imports at end-2009—a standard, but crude, measure of reserve adequacy.[43] This would imply a financing need of US$25 billion.
- The second column shows the change in reserves in the combined simulation of the effects of a larger global downturn on exports, FDI, remittances, and food and oil prices.

The third and fourth columns show the corresponding changes in reserves expressed in months of imports of goods and services.

The fifth and sixth columns assess the total balance of payments shock (i.e., before adjustment or import compression). This is computed by adding up the declines in several components of the balance of payments that may be considered exogenous in the short run: exports, FDI, remittances (measured here by current private transfers), donor grants, and the price effects on imports of the change in food and fuel prices. The fifth column shows the magnitude of these changes in the current baseline projections. The sixth column shows the corresponding results in the simulation. Given the assumed absence of policy adjustment in the simulation, the total shock equals the total reserves loss shown in the second column.

[43] Also including cases where reserves fall by more than 0.5 month of imports, to less than 4 months.

Appendix VI. Balance of Payments Financing Needs /1

	Reserves Change in millions of U.S. Dollars		Reserves Change in Months of Imports of Goods and Services		Total Shock in millions of U.S. Dollars		Reserves Change in percent Fund quota
	Current 2009 proj.	2009 Simul. 2/	Current 2009 proj.	2009 Simul. 2/	Current 2009 proj.	2009 Simul. 2/	2009 Simul. 2/
Afghanistan, I.R. of	.	.	.	.	.	.	.
Albania	5	-349	0.3	-0.5	834	-349	-465
Angola	-13,754	-45,258	-4.7	-16.2	-45,416	-45,258	-10,249
Armenia	-49	-547	-0.2	-1.5	129	-547	-386
Azerbaijan	-1,581	-31,789	-0.8	-27.3	-24,626	-31,789	-12,810
Bangladesh	432	-4,589	0.3	-1.9	3,122	-4,589	-558
Benin	39	67	-1.3	1.5	-145	67	70
Bhutan	30	-135	1.3	-1.5	-548	-135	-1,391
Bolivia	2,488	-468	3.2	-0.7	-897	-468	-177
Burkina Faso	-1	-84	0.8	0.1	50	-84	-91
Burundi	-69	-67	-0.7	-1.1	-15	-67	-56
Cambodia	278	-794	0.7	-1.0	-221	-794	-588
Cameroon	-633	-2,196	-0.7	-3.7	-1,188	-2,196	-767
Cape Verde	-181	-410	-0.6	-3.2	-519	-410	-2,769
Central African Rep.	18	-144	1.0	-3.7	-7,745	-144	-168
Chad	-393	-1,789	-0.9	-5.8	-1,937	-1,789	-2,071
Comoros	7	8	-1.1	1.7	-31	8	56
Congo, Dem. Rep. of	452	-882	0.9	-1.1	-3,693	-882	-107
Congo, Republic of	-2,267	-6,178	-5.3	-12.0	-2,973	-6,178	-4,735
Côte d'Ivoire	-68	-1,074	0.2	-1.0	-88	-1,074	-214
Djibouti	20	-27	0.9	-0.2	-73	-27	-109
Dominica	-8	-14	-0.5	-0.5	-23	-14	-112
Eritrea	125	-73	3.1	-2.2	-11	-73	-299
Ethiopia	73	-1,131	0.0	-1.5	1,182	-1,131	-548
Gambia, The	19	15	0.5	0.6	55	15	31
Georgia	540	-1,974	1.6	-2.9	-1,675	-1,974	-852
Ghana	-1,002	-1,394	-1.0	-1.4	1,187	-1,394	-245
Grenada	22	-14	0.7	-0.2	-86	-14	-77
Guinea	-88	-262	0.0	-1.5	177	-262	-159
Guinea-Bissau	18	-2	-1.5	0.8	41	-2	-7
Guyana	121	-170	1.0	-1.4	-34	-170	-121
Haiti	172	-498	0.6	-2.1	-308	-498	-395
Honduras	-965	-1,683	-0.7	-1.7	-3,255	-1,683	-842
India	-40,878	-15,610	-0.2	0.8	33,689	-15,610	-243
Kenya	283	-548	0.6	-0.2	1,896	-548	-131
Kyrgyz Republic	49	-153	0.3	-0.1	843	-153	-112
Lao People's Dem. Rep.	15	-235	0.1	-1.1	441	-235	-288
Lesotho	-583	-385	-3.1	-2.3	-576	-385	-715
Liberia	67	-437	-0.1	-5.6	-23	-437	-398
Madagascar	-34	-451	0.3	-1.1	-167	-451	-239
Malawi	-158	174	-1.1	1.5	342	174	162
Maldives	654	130	5.8	1.4	415	130	1,031
Mali	-115	-402	-0.6	-1.4	662	-402	-280
Mauritania	-545	-646	-3.0	-3.6	-1,032	-646	-651
Moldova	-614	-1,347	-0.7	-2.4	-145	-1,347	-709
Mongolia	-539	-68	-1.8	0.3	-24	-68	-86
Mozambique	-92	-933	0.2	-2.4	-891	-933	-532
Myanmar	2,090	-99	2.8	-0.1	585	-99	-25
Nepal	1,347	415	3.7	1.8	989	415	377
Nicaragua	811	-745	2.1	-1.5	-1,797	-745	-372
Niger	177	-396	0.0	-2.4	509	-396	-391
Nigeria	-55,970	-55,188	-8.8	-9.4	-44,225	-55,188	-2,041
Pakistan	-2,437	-2,947	-0.5	-0.4	7,490	-2,947	-185
Papua New Guinea	210	-2,451	0.9	-6.0	-820	-2,451	-1,208
Rwanda	32	-15	0.1	0.4	174	-15	-12
São Tomé & Príncipe	-9	6	-2.7	1.2	13	6	53
Senegal	-197	-287	-0.1	-0.3	508	-287	-115
Sierra Leone	-34	-74	0.0	-0.9	41	-74	-46
Somalia	.	.	.	.	.	.	.
Sri Lanka	-1,789	-2,139	-1.4	-1.5	-1,511	-2,139	-335
St. Lucia	-2	-97	-0.2	-1.5	149	-97	-412
St. Vincent & Grens.	7	-99	0.3	-2.9	8	-99	-772
Sudan	-2,076	-10,397	-1.4	-9.1	-6,627	-10,397	-3,973
Tajikistan	-29	122	-0.4	0.7	1,260	122	91
Tanzania	624	-961	1.5	-1.1	783	-961	-313
Togo	15	-111	0.8	-0.2	135	-111	-98
Uganda	293	45	0.7	0.5	1,063	45	16
Uzbekistan	-3,369	-3,520	-8.2	-5.2	259	-3,520	-828
Vietnam	3,637	-7,752	1.5	-1.0	-10,052	-7,752	-1,527
Yemen, Republic of	-142	-1,986	2.1	-0.6	-317	-1,986	-529
Zambia	-151	-1,058	-0.1	-2.6	-1,217	-1,058	-140
Total balance of payment shock (billions) 3/							
Total number					38	60	
Total value					**-165**	**-216**	
Total Reserve loss (billions) 4/							
Total number	35	60					
Total value	**-131**	**-216**					
Additional financing need (billions) 5/							
Total number	22	48					
Total value	**-25**	**-138**					

1/ All changes are relative to the Spring 2008 WEO projection for 2009. See Appendix VI for details.

2/ This corresponds with the simulated combined shocks to exports, remittances, and FDI described in Section VI and Appendix V.

3/ The sum of the shocks to exports, FDI, remittances, and the price effects of food and fuel price changes (but excluding import responses).

4/ The total change in reserves for LICs with reserves losses.

5/ The total change in reserves for LICs with reserves coverage falling below 3 months of imports or reserves falling by more than 0.5 months to less than 4 months.

Sources: WEO database, and Fund staff calculations

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SWIMMING AGAINST THE TIDE: HOW DEVELOPING COUNTRIES ARE COPING WITH THE GLOBAL CRISIS

Background Paper prepared by World Bank Staff for the G20 Finance Ministers and Central Bank Governors Meeting, Horsham, United Kingdom on March 13-14, 2009.

Swimming Against the Tide:
How Developing Countries Are Coping with the Global Crisis

I. Key Messages

The sharp global contraction is affecting both advanced and developing countries. Global industrial production declined by 20 percent in the fourth quarter of 2008, as high-income and developing country activity plunged by 23 and 15 percent, respectively. Particularly hard hit have been countries in Eastern Europe and Central Asia and producers of capital goods. Global GDP will decline this year for the first time since World War II, with growth at least 5 percentage points below potential. World trade is on track to register its largest decline in 80 years, with the sharpest losses in East Asia, reflecting a combination of falling volumes, price declines, and currency depreciation.

Financial conditions facing developing countries have deteriorated sharply. The World Bank estimates that developing countries face a financing gap of $270-$700 billion depending on the severity of the economic and financial crisis and the strength and timing of policy responses. Even at the lower end of this range, existing resources of international financial institutions would appear inadequate to meet financing needs this year. Should a more pessimistic outcome occur, unmet financing needs will be enormous.

The financial crisis will have long-term implications for developing countries. Sovereign debt issuance by high-income countries is set to increase dramatically, crowding out many developing country issuers (private and public). Many institutions that have provided financial intermediation for developing country clients have virtually disappeared. Developing countries are likely to face higher spreads, and lower capital flows than over the past 7-8 years, leading to weaker investment and slower growth in the future.

The challenge facing developing countries is how, with fewer resources, to pursue policies that can protect or expand critical expenditures, including on social safety nets, human development and critical infrastructure. This will be especially difficult for LICs: the slowdown in growth will likely deepen the degree of deprivation of the existing poor, since large numbers of people are clustered just above the poverty line and particularly vulnerable to economic volatility and temporary slowdowns. Many of the most affected LICs are heavily dependent on official concessional flows, which will be under pressure in donor countries facing their own fiscal challenges.

There is a therefore a strong need to expand assistance to LICs to protect critical expenditures and prevent an erosion of progress in reducing poverty. Attention must be directed to protecting the poor through targeted social spending, including expanded safety nets, and to maintaining and expanding the infrastructure assets that will be critical to restoring growth following the crisis. A concerted effort is also needed to support the private sector, especially SMEs, which are essential to a resumption of growth and job creation in developing countries. Creation of a global Vulnerability Fund, financed with a modest portion of advanced country stimulus packages, could go a long way to providing the resources necessary for these efforts.

II. The Impact of Deteriorating Global Conditions on Developing Countries

Overall Impact

What began as a collapse of the US sub-prime mortgage market quickly spread through the financial system, eroding the value of capital, undermining the creditworthiness of major global financial institutions, and triggering massive de-leveraging.[1] Efforts to restore capital adequacy and uncertainty about the underlying value of assets held in the form of sub-prime mortgage backed securities resulted in capital hoarding, causing liquidity to dry up, ultimately compromising the ability of borrowers to finance transactions in both the real and financial sectors. This in turn reduced demand and employment, undermining consumer and business confidence, and triggering a further contraction in demand. According to the IMF's latest World Economic Outlook Update,[2] output in advanced economies is expected to contract by 2 percent in 2009, a sharp downward revision from expectations just a couple of months ago. Forthcoming forecasts by the World Bank and the OECD will likely show a further deterioration in the outlook.

Evidence of the toll that the financial crisis is having on middle-income countries is mounting. Growth prospects for emerging market and developing countries have been revised downward by a similar magnitude as for advanced economies. Central and Eastern Europe and the CIS countries are particularly hard hit given their reliance on external borrowing to fuel high credit growth in recent years. Latin America's prospects are closely tied to those of the United States, with the impact being felt through a variety of channels including declining remittance flows. For East Asia, the decline in external demand is partially offset by lower commodity prices and a large fiscal package in China, but the region's export dependence makes adjustment more difficult. In the Middle East, at least until recently, government spending in oil-producing states has been sustained despite a decline in oil prices. For those countries with capital market access, there has been an across-the-board increase in spreads since June 2007, with some countries facing increases of more than 2000 basis points.

Box 1: ***Food and Fuel Crisis Hangover: The Case of Malawi***:

Conditions in Malawi at the onset of the global financial crisis were less than propitious, making the economy particularly vulnerable to fallout from the global financial crisis. Foreign reserves had been seriously depleted by the food and fuel crisis (having fallen to less than one month of imports in the first quarter of 2008). The deterioration in the terms of trade in 2007 and much of 2008 increased the trade deficit (in constant volumes) by more than 4 percent of GDP while the sharp decline in fertilizer and oil prices since September 2008 and rising tobacco export prices have only offset a small part of this. These conditions led the authorities to agree to a program supported by the IMF's Exogenous Shocks Facility in December 2008 in an amount equivalent to 1.7 percent of GDP despite the "generally solid performance" under the 3-year PRGF-supported program which had been completed in July 2008. Fallout from the food and fuel crisis earlier in the year, and high fertilizer price subsidies in particular, also caused Malawi's fiscal situation to deteriorate (the overall fiscal deficit excluding grants increased from 13.6 percent of GDP in 2007/08 to a projected -16.9 percent in 2008/2009). This has left the government with little fiscal space should the fallout from the crisis begin to manifest itself more starkly. Further undermining the fiscal situation is a sharp depreciation of the British Pound against the Kwacha, which has reduced the budget support from its largest bilateral donor (DFID) from 2 to 1.5 percent of the budget.

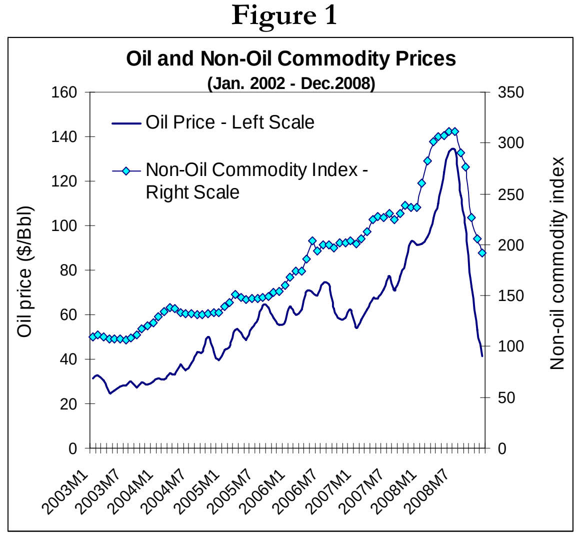
Most low-income countries were shielded from the direct impact of the sudden stop in private capital market flows because they have lower access to such flows. In Sub-Saharan Africa, for example, banks are largely financed domestically or regionally and do not rely significantly on external borrowing to finance operations. But while slower to emerge, the impact of the crisis on LICs has been no less significant as the effects have spread through other channels. Many LIC governments rely disproportionately on revenue from commodity exports, the prices of which have declined sharply along with global demand. These countries have subsequently come under intense fiscal pressure, particularly those with no access to private capital markets which must, if they are to protect core spending, look to ODA and concessional borrowing to fill financing gaps. Foreign direct investment is falling, particularly in the natural resource sectors, as financing becomes scarcer and as declining commodity prices lead to delays or cancellation of major projects. Remittances, which represent a major source of foreign exchange for many LICs, and an important income support for many households, are expected to contract in 2009 after years of rapid growth. In response to their own domestic fiscal pressures, some donors may find themselves under pressure to scale back concessional assistance on which LICs rely for balance of payments and budget support. For other donors, the challenge of meeting their commitments to increase aid has become much more difficult.

While many LICs will likely avoid the outright contraction in output seen in advanced economies,[3] they are considerably more vulnerable to an economic slowdown. The slowdown in growth will likely deepen the degree of deprivation of the existing poor. In many LICs, large numbers of people are clustered just above the poverty line and are therefore particularly vulnerable to economic volatility and temporary slowdowns. Many of the LICs most affected by the crisis have weak institutional capacity, limited fiscal space and high existing levels of household vulnerability which present additional challenges in coping with the growth, fiscal and poverty impacts of the crisis.

Declining Commodity Prices

Part of the fallout from the financial crisis has been a precipitous decline in the prices of a large number of basic commodities,[4] and the weakness in global demand, is expected to keep commodity prices low for a prolonged period. During the second half of 2008, non-energy commodity prices plunged 38 percent, with most indices ending the year well below where they started. In December, non-energy prices fell 6.8 percent, down for the fifth consecutive month on weak global demand. Primary commodity prices continue to display extraordinary volatility, falling swiftly as the downturn in global activity has intensified. Oil prices fell 69 percent between July and December 2008, reversing the oil price increases of the previous 3½ years. Non-oil commodities also fell 38 percent on average over the same period, with substantial declines in the dollar prices of food commodities, beverages, agricultural raw materials and metals and minerals (Figure 1).

Figure 1



Source: DEC Prospects Group, World Bank

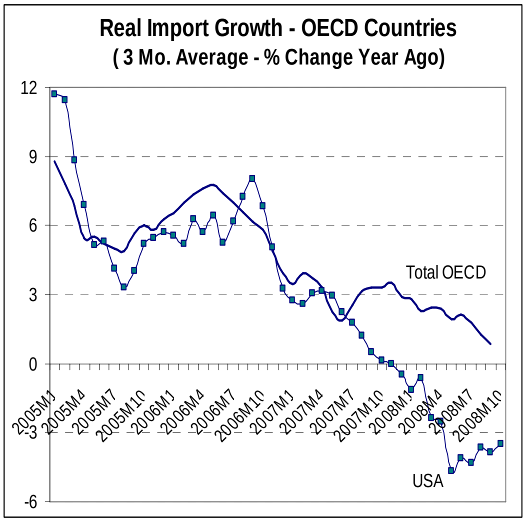
The dramatic fall in commodity prices is affecting different developing countries differently. Just as the *increase* in food and fuel prices between early 2007 and mid 2008 created both winners and losers among developing countries,[5] the sharp *decline* in commodity prices has done the same. Of the 68 developing countries with available data which experienced deteriorating terms of trade during the first three quarters of 2008, all but eight saw a partial reversal of the deterioration in the final quarter of the year. Of the 39 countries for which the terms of trade improved in the first three quarters, all but two saw a partial reversal in the final quarter. Oil-importing emerging market countries—including many Asian countries—were the top gainers from the oil price decline, receiving an income boost of some 2 percent of GDP, on average.[6] Many oil exporters, faced with a sharp drop in prices, have been able to draw on savings and reserves accumulated when prices were at historically high levels and indeed many of the countries that gained from recently high prices have been prudent in saving more of their gains than in previous commodity price booms (e.g., Nigeria). Such expenditure smoothing may help mute the impact of extremely volatile commodity prices on the real economy. Nevertheless, for some low-income commodity producers, the cumulative windfall was not large, particularly relative to their development needs. And for some commodity producers, the high prices from 2007 and into 2008 followed on the heels of a prolonged period during which their terms of trade declined.[7]

In many countries, commodities generate a large share of government revenue. This is particularly the case for major oil exporters and many LICs. In Africa, for example, oil is responsible for generating more than half of all revenues for Congo, Equatorial Guinea, Gabon and Nigeria; cocoa generates almost one-fifth of Cote d'Ivoire's revenue as do minerals in Guinea.[8] On average between 1999 and 2004, cotton and aluminum accounted for almost one-fifth of tax revenues in Tajikistan.[9] For at least nine Latin American countries, commodity revenue was, on average, at least 2 percent of GDP between 2002 and 2007.[10] For Trinidad and Tobago and Bolivia, respectively, this share has recently been as high as 22 and 12 percent of GDP. Respondents to a survey of Bank country teams in LICs have indicated that commodity-based revenues have already started to decline in many LICs. Careful monitoring of this trend is needed, while at the same time, it is essential that donors increase budget and other financial support to vulnerable LICs to avoid long-lasting setbacks to poverty reduction efforts.

Collapsing Global Trade

Falling demand in advanced economies has had serious implications for global trade, with 2009 expected to experience the first yearly decline in world trade volumes since 1982, the largest decline in 80 years. Advanced country imports are projected by the IMF to contract by 3.1 percent in real terms compared to earlier expectations of no change in volumes, and further downward revision is likely. The counterpart to this is the expectation of a virtually unprecedented decline (of close to 1 percent) in exports from emerging and developing economies. Figure 2 gives some indication of the magnitude of the slowdown in OECD country imports. Although 70 percent of global trade is between advanced countries, developing economies are highly dependent on advanced country markets for their exports. South-South trade only represents about 10 percent of global trade.

Figure 2:



Source: World Bank data and staff estimates.

Table 1

US Imports from Developing Countries October-November 2008

	US$ Billion	% Ch.*
All Developing	170.8	-3.2
Middle Income	155.0	-2.9
Low Income	15.8	-5.8
Sub Saharan Africa	11.4	-11.5
East Asia & Pacific	2.4	13.4
Eastern Europe & Central Asia	0.1	-17.7
Latin America & Caribbean	1.1	-2.4
Middle East & North Africa	0.0	38.2
South Asia	0.8	11.6

Source: US Commerce Department and World Bank staff calculations. Excludes small economies.

* % change from year ago.

Deteriorating growth in global trade has been underway for some time. In the last quarter of 2008, trade growth turned negative, raising fears in many corners of a protectionist backlash (Annex 1). Of the 51 economies reporting fourth quarter data for 2008, 36 show double-digit declines in nominal exports relative to a year ago. Many European countries, including the United Kingdom and Spain, as well as developing countries such as Indonesia, Philippines and Turkey registered a drop in exports of 20 percent or more. In October, India registered its first every year-over-year decline in exports (of 15 percent), following growth of 35 percent in the previous five months. In December, Brazil reported its first trade deficit in almost eight years, as exports plunged 29 percent. Data for January are available for only a handful of countries but show a sharp drop in exports relative to levels a year ago. Longer data lags make it difficult to evaluate what is happening to LIC exports, but a partial picture can be obtained by looking at import data from advanced countries. Table 1 suggests that LIC exports are already being seriously impacted, with US imports from LICs in October-November 2008 down almost 6 percent from a year earlier.

Weak global demand is compounded by a drying up of trade finance. Traditionally, some 80 percent of world trade is financed through open account transactions, leaving about US$2.8 trillion to be financed using various trade finance instruments. But with no comprehensive data available, an overall assessment of developments in trade finance is difficult. Emerging evidence suggests that the demand for traditional instruments such as letters of credit is strong as international traders, including in advanced economies, are increasingly requiring means of payment that are more secure than open account transactions.

Small and medium enterprises (SMEs) are especially challenged by the deteriorating risk landscape and are being crowded out by large firms who had previously financed international sales on "open account."[11] At the same time, the collapse in the supply of trade finance has been compounded by a sharp increase in capital requirements associated with the move to Basel II capital adequacy standards. As a result, the cost of trade finance has increased across the board.

According to Dealogic,[12] global trade finance shrunk by about 40 percent in the last quarter of 2008 relative to 2007.[13] In total, only 116 trade finance loans (excluding aircraft and shipping) were signed in the last quarter of 2008, the lowest quarterly deal count since 2004. Preliminary results from a recent IMF survey of 40 advanced economy and emerging market banks indicate that there was a widespread increase in pricing of all trade finance instruments relative to banks' costs of funds toward the end of 2008, with major traders paying 100 to 150 bps over trend.

Disappearing Private Capital Flows

Nowhere is the impact of the financial crisis more evident than in the global capital markets on which emerging markets and many developing countries rely. According to the Institute for International Finance, net private capital flows to emerging markets are estimated to have declined to US$ 467 billion in 2008, half of their 2007 level.[14] A further sharp decline to US$165 billion is forecast for 2009, with just over three-quarters of the decline due to deterioration in net flows from commercial banks. The Bank estimates that in 2009, 104 of 129 developing countries will have current account surpluses inadequate to cover private debt coming due. For these countries, total financing needs are expected to amount to more than $1.4 trillion during the year. External financing needs are expected to exceed private sources of financing (equity flows and private debt disbursements) in 98 of the 104 countries, implying a financing gap (i.e., not taking into account flows from official sources) in 98 countries of about $268 billion. Should rollover rates come in lower than expected, or capital flight significantly increase, this figure could rise to almost $700 billion.

There is a growing recognition that the rollover of maturing debt constitutes a key risk to emerging markets, especially banks and corporates, for which the lack of access, combined with limited domestic capital markets, will put additional financial pressure on governments who themselves are foreign capital constrained. Preliminary estimates suggest that well over $1 trillion in EM corporate debt and $2½-3 trillion in total EM debt matures in 2009, the majority of which reflects claims of major international banks extended cross-border or through their affiliates and branches located in emerging markets. Most of this lending is in foreign currency, and for relatively short terms, meaning that the currency and maturity risks are primarily on the balance sheet of EM banks, corporate and households. There is mounting evidence of growing pressure on interbank lines, particularly those extended to the corporate sector. Recent evidence of rollover efforts on public debt of major corporates indeed suggests that even stronger corporates in key emerging markets are struggling.

While small in global terms, Africa has been relying increasingly on private capital inflows (Figure 3). But given the small size of domestic securities markets, even a small decline in these flows could have a sizeable impact on securities prices. In terms of market borrowing, there have been no international bond issues by African countries in 2008, compared with US$6.5 billon in 2007.[15]

With credit conditions tightening, foreign direct investment is expected to decline in all regions (Figure 4) and will be particularly pronounced in those sectors (e.g., mining, oil) for which price declines have been particularly large. The impact of sharply lower oil prices and cuts in production is also having a negative impact on FDI in non-oil producers, particularly in the Arab world, as GCC countries cut their investments abroad. The World Bank's Public-Private Infrastructure Advisory Facility (PPIAF) reports that the value of PPI projects that reached financial closure between August and November 2008 was down 40 percent compared to a year earlier. A recent survey of World Bank economists suggests that concerns about the adverse impact of the crisis on FDI are widespread, affecting three-quarters of LICs, particularly those in Sub-Saharan Africa and Central Asia. Numerous projects are being cancelled, delayed or at risk of being delayed on account of significantly lower commodity prices.

Figure 3: Sub-Saharan Africa Capital Inflows

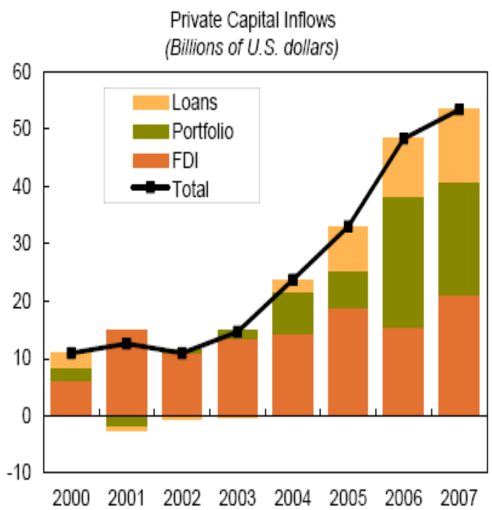
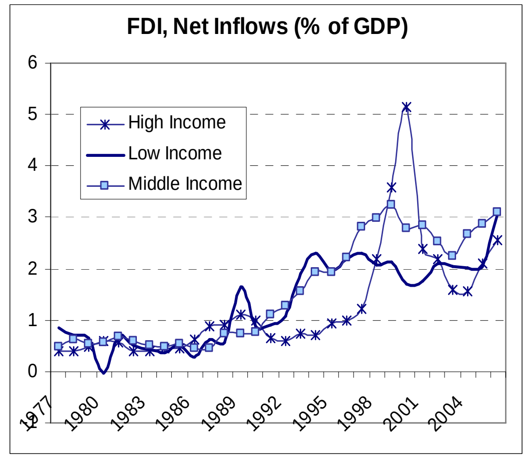


Figure 4: Foreign Direct Investment



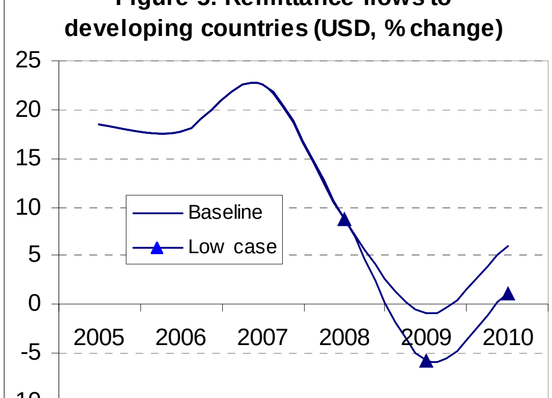
World Bank World Development Indicators.

The shortage of affordable financing will have major repercussions for infrastructure spending, which is critical for longer-term growth. New private activity in developing countries between August and November 2008 was about 40 percent lower than the same period in 2007, reflecting the impact of the financial crisis on the availability of financing. In several developing countries, major depreciations against the dollar have made foreign currency denominated debt too expensive. About one quarter of projects surveyed by IFC have been delayed, canceled, or are at risk of being canceled. A similar trend was experienced after previous financial crisis. Investments in private infrastructure projects in East Asia and Latin America declined substantially after the late 1990s crises in developing countries and had not recovered their pre-crisis levels by 2007. Maintaining, constructing or rehabilitating much needed public infrastructure such as roads, water supply and sewerage systems, drainage canals, and urban infrastructure (including slum upgrading) is critical to sustained development and growth, including by influencing the location of new private sector activities.

Dropping Workers' Remittances

Remittance flows are estimated to have reached $305 billion in 2008, an increase of around 9 percent from 2007, but with a sharp deceleration in the second half of 2008. World Bank projections suggest that remittances to developing countries will fall in 2009 (Figure 5). The steepest decelerations in 2008 have been for Sub-Saharan Africa and Europe and Central Asia, although moving into 2009, South Asia is particularly vulnerable given the importance of the GCC countries as a source of remittances. In the past,

Figure 5: Remittance flows to developing countries (USD, % change)



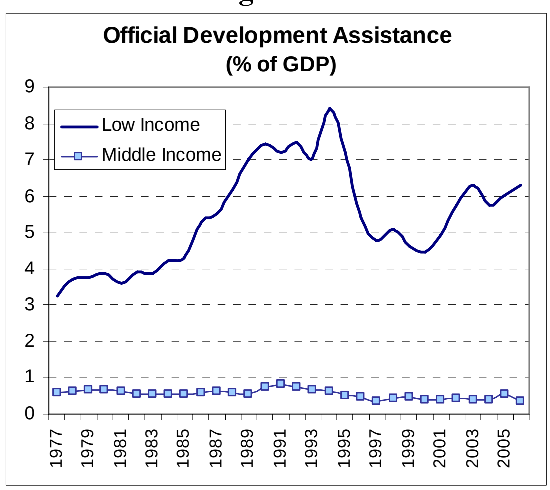
Source: World Bank data and staff estimates remittances have been stable, or even counter-cyclical, during an economic downturn in the recipient economy. This time, however, the crisis has affected remittance source as well as recipient countries. Since workers' remittances traditionally help finance consumption and SME investment in recipient countries, the deceleration in growth and possible decline is of great concern.

The situation is particularly problematic for those countries for which remittance inflows are large relative to GDP. The top recipients in terms of the share of remittances in GDP included many smaller economies such as Tajikistan (45 percent), Moldova (38 percent), Tonga (35 percent), Lesotho (29 percent), and Honduras (25 percent), Lebanon (24 percent), Guyana (24 percent). For a number of countries, declines in remittance inflows have been compounded by unfavorable exchange rate movements. Particularly problematic is the situation of countries like Tajikistan, Moldova, Kyrgyz Republic, and Armenia for which Russia is the main source of remittances. Many of these workers are employed in the oil and gas industry, sectors which are suffering from the precipitous decline in prices. Compounding this is the sharp depreciation in Russia's currency in the second half of 2008 and into early 2009 (falling about 35 percent against the US$), significantly reducing the local currency value of ruble-denominated remittances.

Squeezing Aid Flows

Budget support needs are increasing, but ODA commitments are uncertain. Historically, ODA to low income countries has been quite volatile, falling by around 3 percentage points of LIC GDP between the early and mid 1990s (Figure 6). Even before the onset of the financial crisis, developed countries as a group were falling short (by around $39 billion a year) of their Gleneagles commitments to significantly increase their aid and double aid to Africa. The concern now is that official aid flows could become even more volatile in the wake of a widespread global financial crisis and recession. Evidence of the impact of the crisis on donor budgets is mixed. While a few donors have signaled their intention to scale back their ODA budgets others have reaffirmed earlier commitments to increase ODA, at least for the upcoming fiscal year. For many low-income countries, there are few alternatives to development assistance when faced with crisis-related declines in export and fiscal revenues. Moreover, the channels through which the crisis is affecting them threaten recent progress in increasing social and core infrastructure spending, pointing to a growing need for quick disbursing budget support. With revenue expected to decline significantly, particularly in LICs, the ability to protect core development spending will depend heavily on receiving increased budget support from donors. On the positive side, almost three-quarters of developing countries are deemed to have the institutional capacity to effectively absorb at least some scaling up of budget support.

Figure 6:



Source: World Bank World Development Indicators.

III. Impact on the Poor and Most Vulnerable

What does this mean for the poor? The economic crisis is projected to increase poverty by around 46 million people in 2009. The principal transmission channels will be via employment and wage effects as well as declining remittance flows. While labor markets in the developing world will take a while to experience the full effects of the on-going global contraction, there is already clear evidence of the fall-out. The latest estimates from the Ministry of Labor in China show 20 million people out of work. So far, the most affected sectors appear to be those that had been the most dynamic, typically urban-based exporters, construction, mining and manufacturing. The **garment industry** has laid off 30,000 workers in Cambodia (10% of workforce) where it represents the only significant export industry. In **India,** over 500,000 jobs have been lost over the last 3 months of 2008 in export-oriented sectors—i.e., gems and jewelry, autos, and textiles. ILO forecasts suggest that global job losses could hit 51 million, and up to 30 million workers could become unemployed.

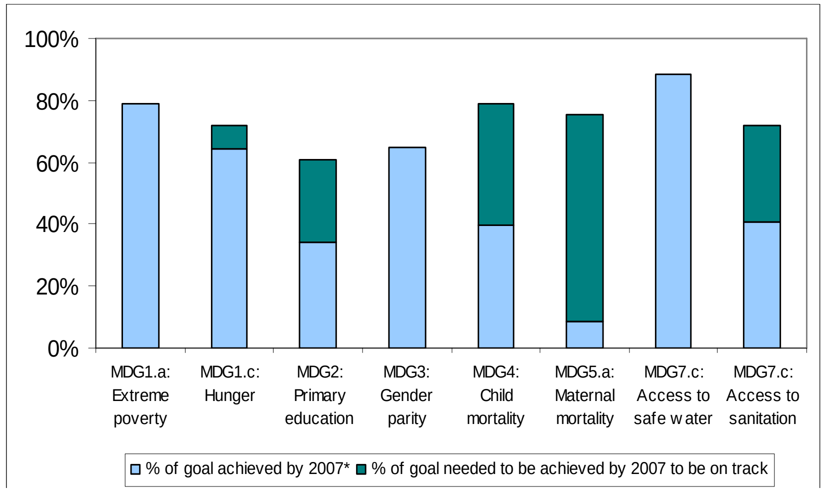
Workers are increasingly shifting out of dynamic export-oriented sectors into lower productivity activities (and moving from urban back into rural areas). These trends are likely to jeopardize recent progress in growth and poverty reduction resulting from labor shifting to higher return activities. For instance, nearly half of the increase in GDP per capita experienced in Rwanda between 2000 and 2008 is explained by movement of labor away from agriculture into the secondary and tertiary sectors.[16]

Declining remittances and migration opportunities are also undermining poverty gains and depressing wages. Remittances are a powerful poverty reduction mechanism, so that the current forecasts for a significant decline in remittances in 2009, will have strong welfare impacts in some countries.[17] Estimates for Tajikistan suggest that halving of the remittance flows would raise the poverty headcount from 53% to 60% and would deepen poverty and inequality.[18] According to recent projections in Bulgaria and Armenia, two countries heavily dependent on migration, a decline of 25% in remittances would increase poverty rates among recipients from 7% and 18% respectively to nearly 23% and over 21% respectively.[19] The international return flows of migrants as well as reduced new departures will reinforce the shortage of employment opportunities and further strain tight labor markets in the developing world.

Falling real wages and employment impede households' ability to provide adequate food and necessities to their members, particularly given their already stretched coping mechanisms from the 2008 food and fuel crises. Compounding this is the very real risk that, in many countries, fiscal pressures will result in reduced services to the poor, which is particularly problematic at a time when people are switching from private to public education and health services. Absent assistance, households may be forced into the additional sales of assets on which their livelihoods depend, withdrawal of their children from school, reduced reliance on health care, inadequate diets and resulting malnutrition. The long-run consequences of the crisis may be more severe than those observed in the short run. When poor households withdraw their children from school, there is a significant risk that they will not return once the crisis is over, or that they will not be able to recover the learning gaps resulting from lack of attendance. And the decline in nutritional and health status among children who suffer from reduced (or lower-quality) food consumption can be irreversible. Estimates suggest that the food crisis has already caused the number of people suffering from malnutrition to rise by 44 million.[20]

Experience from past crises suggests the potential for a slowdown in progress towards the MDGs (Figure 7). Even prior to the crisis, most human development MDGs—especially for child and maternal mortality but also primary school completion, nutrition, and sanitation—were unlikely to be met. Until recently, stronger progress in reducing income poverty had put the MDG for poverty reduction within reach at the global level, but the combination of food, fuel, and now, financial crises, has raised new obstacles. While the magnitude of the setback is difficult to assess at this point, countries that suffered economic contractions of 10 percent or more between 1980 and 2004 experienced, for example, more than one million excess infant deaths. Evidence suggests that growth collapses are costly for human development outcomes, as they deteriorate more quickly during growth decelerations than they improve during growth accelerations. The average GDP growth rate of developing countries is now projected to fall in 2009 to less than half the pre-crisis rate. The projected lower growth path will sharply slow the reduction in infant mortality. Preliminary analysis shows that, as a result, infant deaths in developing countries may be 200,000 to 400,000 per year higher on average between 2009 and the MDG target year of 2015 than they would have been in the absence of the crisis. Unless reversed, this corresponds to a total of 1.4 to 2.8 million excess infant deaths during the period. Progress towards the MDGs is expected to pick up when growth recovers, but achievement of the goals will be further delayed.

Figure 7: Progress towards MDGs --- all developing countries



IV. Policy Challenges in Responding to the Crisis

In responding the global economic crisis, developing and emerging market countries will face three main challenges:

- *Stabilization:* The crisis threatens growth, employment, and balance of payments stability even in those countries that have made significant improvements in macroeconomic management in recent years. Give the unprecedented severity of the crisis, few countries will be able to avoid heavy pressures on their fiscal and external positions. The challenge for policymakers in this environment is to assess their ability to undertake countercyclical policies given the resources available to them as well as their institutional and administrative capacity to rapidly expand and adapt existing programs. [21]

- *Protecting Longer-Term Growth and Development*: An important lesson learned during the Asian crisis is that neglecting core development spending during a major crisis can have large long-run costs. Responding to immediate fiscal pressures by putting off maintenance of existing infrastructure essential for economic development, for example, can lead to costly rehabilitation over the longer term and also hold back economic recovery. The same can be said of reduced public spending on human capital development, such as basic education.

- *Protecting the Vulnerable.* Inevitably, the crisis will impact social and human development objectives. Declining growth rates combined with high levels of initial poverty leave many households in developing countries highly exposed to the crisis. The Bank estimates that of 116 developing countries, 94 have experienced decelerating growth, of which 43 experience high levels of poverty. This implies new spending needs and may warrant a re-prioritization of existing public spending. While impacts are country specific, the crisis entails real risks for future poverty reduction and exposes poor and vulnerable households to potentially severe welfare losses. Households in the poorest countries are the most in danger of falling back into poverty and have less access to safety nets to cushion the impact. To some extent, countries that established or improved the efficiency of social safety nets during the food and fuel crisis can utilize these channels to protect the poorest and most vulnerable. Critical to protecting households in exposed countries will be the ability of governments to cope with the fallout and finance programs that create jobs, ensure the delivery of core services, and provide safety nets. However, given the scarcity of resources, the challenge remains to continue to improve the targeting and effectiveness of social support.

Pursuing these objectives can require significant resources. But in an environment characterized by rising needs and scarce resources, policymakers face difficult challenges of setting spending priorities and maximizing the development impact of their spending. These challenges are particularly daunting for debt-distressed countries for which the resources constraints are often greatest. Even if a country's public debt is low, it may find it difficult to finance a large fiscal stimulus package.

There is also considerable uncertainty with respect to both the severity and length of the economic downturn, further complicating the task of policy makers. A less protracted slowdown would suggest a focus on shorter term measures that are easily reversible, emphasizing (where possible) the acceleration of pre-existing spending plans rather than new initiatives. A more protracted slowdown would lengthen the horizon over which it would be desirable to implement countercyclical polices. With no clear sense of the length and depth of the crisis, contingency planning and enhanced monitoring of evolving economic and fiscal conditions will be critical.

V. Limiting the Damage from the Crisis

To date, all advanced economies and a majority of developing countries in the G-20 have announced plans for some level of fiscal stimulus. As of end January, this amounted to almost US$1 trillion for 2008 and 2009[22] combined, with a further US$650 billion in 2010. Of these amounts, the major portion—more than four-fifths—is being undertaken by advanced economies. With virtually all countries expected to be affected by the crisis, many will be looking to cushion the impact on their citizens. Yet, according to Bank analysis, only one quarter of vulnerable developing countries are in a position to expand their fiscal deficit to undertake significant countercyclical spending.[23] Moreover, one-third of these countries is aid dependent and will require additional external support to finance increased spending.

At the same time, there is a clear need for countercyclical fiscal stimulus in response to the contraction in global demand. However, many countries, particularly LICs, lack the resources to undertake the types of measures that could make a real difference in the lives of those impacted by the crisis. To a significant extent, a country's ability to respond to the needs of its people is a function of its fiscal and external positions leading into the crisis, with countries that have a more favorable starting position more likely to have room to implement countercyclical fiscal policy.[24] Countries with large accumulated reserves and fiscal surpluses, for example, may be able to offset some of the drag on the domestic economy through discretionary expenditure and tax measures. But many governments, particularly in LICs and countries negatively impacted by the earlier food and fuel crisis, have found it increasingly difficult—if not impossible—to cushion the effects of the crisis on their populations, as weak revenue performance puts budgets under additional pressure, placing the delivery of basic services at risk and precluding the adoption of a stimulus packages without external assistance. Many of the countries most affected by the crisis, and those at the lower end of the development scale, also have weak institutional capacity and high existing levels of household vulnerability, which will make it very difficult for them to cope with the growth, fiscal and poverty fallout from the crisis.

Box 2: India's Infrastructure Response

In response to rapidly deteriorating growth, the central government has allowed the India Infrastructure Finance Company Limited (IIFCL) to raise r400 billion (0.7 percent of GDP) to help with the financing of projects (largely for road and ports) that were being implemented as public-private partnerships (PPPs). The infrastructure projects that are eligible for financing (mainly in the roads and port sectors) were well-advanced in their design and many were near financial closure prior to the crisis and had been, or were at the risk of being, delayed on account of the global credit crunch. The additional resources being made available through the IIFCL will refinance loans originally provided by commercial banks. This will ensure that these projects, which will help address some of the infrastructure bottlenecks that have been a huge constraint on India's long-term growth, are able to proceed, and help support aggregate demand and protect jobs during the economic downturn.

With the expectation of falling revenues and a scarcity of affordably-priced capital, protecting core social and infrastructure spending will become more difficult. And with the likely increase in demand for social safety nets, particularly as unemployment rises, the cost of existing social support programs can be expected to increase. But as noted previously, the long-term cost of neglecting either social support or infrastructure maintenance can be significant,[25] suggesting a critical need to protect spending in these areas.

In many cases, the drying up of liquidity will threaten the viability of developmentally-important public-sector or public-private capital projects. The disappearance of financing could be the result of a fundamental shift in market conditions making it difficult for governments to follow through on previous plans to borrow from markets or, in the case of public-private partnerships, the inability of a private-sector partner to finance its originally agreed participation. Projects of this type that are well advanced could favorably impact domestic demand quite quickly if completed. Were they delayed or even cancelled due to the evaporation of expected financing, an important part of the foundation for future growth in output, employment and productivity would be lost. Recognizing this, policymakers in a number of countries are working to put in place alternative arrangements to replace financing no longer available from private partners (Box 2).

Getting the "biggest bang" for the stimulus "buck" will be key to limiting the damage caused by the crisis. Augmenting or accelerating the implementation of existing public works or investments may be one option that is open to policymakers in developing countries. Assuming both financing and implementation capacity are available, bringing forward future spending to a time when labor market conditions are particularly weak can help preserve jobs and head off a potential burden on social safety nets. Augmenting spending on, for example, maintenance of existing infrastructure, particularly when it is in disrepair, may also provide a rapid channel for generating employment consistent with enhancing longer-run growth and development.

New spending initiatives (including on infrastructure) are also an option, if appropriate financing can be mobilized, particularly if they can be implemented quickly and are expected to contribute to a country's long-run growth potential. Investments in clean technology could conceivably fall into this category. However, uncertainty about the length of the crisis, and the difficulty in obtaining longer-term financing commitments in current market conditions, suggests the need for caution in approaching ambitious projects for which a significant share of spending may not take place for several years. Besides the opportunity cost in terms of forgoing a more immediate fiscal stimulus, there is the risk that such spending ends up being pro-cyclical.

To lay the ground for recovery, it will also be important that small and medium-sized enterprises are able to obtain the financing necessary to create and develop opportunities for growth and employment. SMEs play a critical role in economic recovery, often acting as the "best safety net". This highlights the importance of protecting access to financing for this particular vulnerable segment of the private sector. A number of initiatives are underway, including through the use of public guarantees to private financial institutions to support the ongoing provision of finance to SMEs Using newly gathered data for 91 banks from 45 countries, research by World Bank staff finds that banks in developing countries perceive the SME segment to be highly profitable, but see (in descending order) macroeconomic instability, high interest rates, and exchange rate risk as the main obstacles to continued lending.[26] This underlines the importance assigned by policymakers to macroeconomic stability in creating an environment conducive to recovery.

VI. Responding to the Crisis—How the World Bank is Helping

The World Bank Group has an important role to play in helping developing countries assess and respond to the challenges presented by the global economic crisis. The Bank is well positioned to play a role in helping its clients stabilize their economies, preserve and enhance the foundations for longer-term economic growth, and protect the most vulnerable against fallout from the crisis. Because of the magnitude of the crisis and the heterogeneity of its impact on individual developing countries, the Bank is mobilizing a wide range of support, which will be tailored to country and community needs, including through technical assistance and policy advice, direct financing, and by helping to leverage financial support from a variety of public and private sources. The Bank is actively working with other IFIs and MDBs to design, develop and implement many of the new approaches and instruments it is proposing

Taken together, financial needs are considerable. The World Bank Group is stepping up its financial assistance to its clients on a number of fronts. There is scope to almost triple lending to around $35 billion in FY2009, and lending volumes could potentially reach $100 billion over the next three years. Following its record 15th replenishment, IDA is positioned to assist LICs in dealing with the impact of the global financial crisis, with commitments amounting to nearly $42 billion over the next 3 years, and scope for front-loading this support over the next year. The Bank is at the forefront of global efforts to mobilize resources for developing countries, particularly those without the means to cushion the impact of a crisis not of their making.

Central to this effort is a World Bank proposal for an umbrella Vulnerability Fund to

which developed countries could dedicate 0.7 percent of their planned economic stimulus. The Vulnerability Fund, which could channel resources not only through the Bank but also through the UN or other MDBs, would help countries without the resources to respond to the crisis by funding investments in three key areas:

- **Infrastructure projects** that would help put people in developing countries back to work while building a foundation for future growth and productivity.

- **Safety net programs**, such as conditional cash transfers that make it possible for people to keep their children in school, get adequate nutrition and seek health care.

- **Financing for small and medium-sized businesses and microfinance institutions** to help the private sector create jobs.

The Bank continues to adapt its financial instruments to the specific needs of its clients. The World Bank Group is also establishing a comprehensive IBRD/IDA Vulnerability Financing Facility (VFF) to streamline its support to protect the poor and vulnerable during global and systemic shocks. The VFF could be one option for countries wishing to contribute to the Vulnerability Fund. Along with its support to the private sector and to sustain infrastructure investment, the VFF is part of an emerging framework for addressing developing country vulnerability to crises. The VFF currently incorporates three initiatives: (i) the Global Food Crisis Response Program (GFRP); (ii) the IDA Fast-Track Facility, which will fast-track up to $2 billion of financial assistance, with potential to increase this amount in future; and (iii) the Rapid Social Response Fund to help protect the poor and vulnerable in middle and low-income countries affected by different dimensions of the global crisis. These initiatives focus respectively on three key areas of vulnerability response: (i) agriculture, which is the main livelihood for the majority of the world's poor, (ii) programs to protect investments in longer-term development in the poorest countries, and (iii) employment, safety nets and protection of basic social services to help the poor and vulnerable groups cope with crisis.

To respond to the challenges the current crisis presents for the infrastructure sector, the WBG is also launching an Infrastructure Recovery and Assets (INFRA) Platform. The objectives of the three-year INFRA Platform are to: (i) stabilize existing infrastructure assets by restructuring current portfolios, covering maintenance costs, and advising clients on currency and interest rate risk management; (ii) ensure delivery of priority projects through Public Expenditure Reviews and government capacity building, by accelerating disbursements and/or identifying additional financing, and by seizing the opportunity for "green infrastructure" through access to leveraging facilities, (e.g. Carbon Partnership Facility, Clean Technology Fund); (iii) support Public Private Partnerships (PPPs) in infrastructure through advisory and restructuring support, use of Bank Group guarantees, innovative instruments, and in coordination with the IFC Infrastructure Crisis Facility; and (iv) support new infrastructure project development and implementation by providing financing and advice to governments launching growth and job enhancement programs, as well as new infrastructure projects.

IBRD/IDA aims to support the achievement of the INFRA Platform objective through.

- Direct IBRD and/or IDA funding of infrastructure projects of up to $15 billion per year

- Diagnostic and advisory support to identify countries most at risk and projects most appropriate for INFRA support

- Technical assistance to governments in the development of fiscal stimulus packages
- Providing parallel financing to ensure collaboration and complementarity among bilateral and IFI financing for priority projects
- Providing concessional financing for project preparation and financing for priority projects to mobilize additional funds for infrastructure development

In addition to direct financial support, the Bank continues to provide developing countries with access to diagnostic and capacity-building instruments like Public Expenditure Reviews (PERs) and Debt Management and Performance Assessments (DEMPA)—the former to help improve budget management and identify priority expenditures to be protected should financing shortfalls persist, the latter as a critical tool for assuring essential fiscal sustainability. The value to developing countries of these instruments has increased in a resource constrained environment, as will the usefulness of technical assistance to improve revenue and customs administration. A number of client countries are also looking for assistance in building bank supervisory capacity to enable them to more effectively monitor developments and respond to weaknesses in domestic financial sectors as they emerge.

The IFC Private Sector Platform will provide support to the private sector in LICs and vulnerable MICs for crisis-related activities. The International Finance Corporation (IFC) has launched or expanded five facilities to address problems experienced by the private sector. Financing for the new facilities is expected to total about US$30 billion over three years, combining IFC funds and externally mobilized resources, including from governments, export credit agencies, and international financial institutions. Among the efforts underway are:

- **Expansion of the Global Trade Finance Program (GTFP).** The existing program, which offers banks partial or full guarantees on the payment risk in trade transactions, was doubled in size and can now support up to US$18 billion in short-term trade finance over the next three years. Since its inception in September 2005, US$3.2 billion in trade guarantees have been issued in support of 2,600 transactions. Of these, 48 percent were for banks in Africa, 70 percent involved small and medium enterprises, half supported trade with the world's poorest countries, and 35 percent facilitated trade between emerging markets. The expanded facility is expected to benefit participating banks in more than 65 developing countries.

- **Creation of a Global Trade Liquidity Pool (GTLP).** While expansion of the GTFP greatly increases the potential to support trade finance through the use of guarantees, the severe shortage of liquidity has made it difficult for many companies to line up the basic financing to be guaranteed. IFC is therefore working with a number of partners to create a funded Global Trade Liquidity Pool and will seek Board approval for its adoption at the end of March. With the involvement of a number of global or regional banks active in trade finance, the GTLP will fund trade transactions for up to 270 days and will be self liquidating once conditions for trade finance improve.

- **Bank Recapitalization Fund.** IFC recently approved a US$3 billion Bank Recapitalization Fund to provide Tier I and Tier II capital to distressed banks in emerging markets which lack alternative sources of financing. It will also provide advisory services to strengthen private sector development and improve economic and financial performance. IFC expects to invest US$1 billion of its own money. Japan has announced its intention to become a key founding partner and provide the remaining US$2 billion in financing.

- **Infrastructure Crisis Facility.** This IFC facility, which is part of the WBG's broader Infrastructure Recovery and Assets (INFRA) Platform, will help ensure that viable, privately-funded infrastructure projects in emerging markets have access to the funding they need to weather the financial crisis by providing temporary financing to private or public-private partnership infrastructure projects in emerging markets. Among other things, it will roll-over financing and temporarily substitute for commercial financing for new infrastructure projects, if funding is unavailable. IFC expects to invest a minimum of US$300 million and mobilize between US$1.5 billion and US$10 billion from other sources.

- **Microfinance Liquidity Facility.** As one of the top three international investors in microfinance, IFC has designed a liquidity facility to help ensure availability of adequate refinancing for Microfinance Institutions amidst the market turmoil. The US$500 million facility is a joint effort with Germany's KfW. Using three of the industry's largest fund managers, the facility will provide refinancing options of up to 70 percent of the microfinance market. IFC expects to invest up to $150 million.

In addition, IFC will contribute up to €2 billion in a coordinated effort (with the EBRD and the EIB) to finance assistance to businesses hit by the crisis in Central and Eastern Europe. It will be disbursed through IFC's various crisis response initiatives in sectors including banking, infrastructure, and trade as well as through its traditional investment and advisory services. This is part of a broader €24.5 billion joint effort to support the banking sectors in the region and to fund lending to businesses hit by the global economic crisis, of which the World Bank Group will provide support of about €7.5 billion.

The Multilateral Investment Guarantee Agency (MIGA) continues to focus its guarantee activity in higher risk/low income countries and on difficult structured finance transactions. During December of 2008 and January 2009, MIGA approved US$675 million in guarantees in support of loans to three foreign-owned financial institutions operating in Ukraine. A US$95 million guarantee was provided to a subsidiary of foreign-owned financial institution operating in Russia. Similar guarantees are being explored for banks operating in other Eastern Europe countries and in Africa, in collaboration with IFC. MIGA is in the process of proposing changes to its operational regulations to allow it to respond more rapidly to emerging needs.

VII. Urgent Priorities

By any standard, the magnitude of challenge faced by policymakers is massive and minimizing the impact of the crisis on vulnerable populations and households is going to require concerted and coordinated action. On the positive side, there is a growing recognition of what needs to be achieved to put all countries—advanced and developing—back on the path to sustained growth and poverty reduction:

1. **Restore confidence**: Only by restoring confidence in the global financial system will the financing needed for growth—including through short-term trade finance, medium-term debt rollovers, and long-term FDI, including via public-private partnerships—resume at the level required to restart growth.

2. **Restore aggregate demand**: Without restoring aggregate demand, job prospects will remain poor and unemployment will continue to rise, creating its own cycle of economic, social and political pressures. Key to this will be renewed growth in global trade, with the

provision of trade finance a high priority. But one of the greatest threats to increased trade flows is protectionism and beggar-thy-neighbor policies, which need to be resolutely resisted.

3. **Increase concessional flows**: With needs mounting, and progress to the MDGs under increasing threat, now is not the time to cut pull back from commitments to increase both the quantity and quality of ODA. Indeed, under current circumstances, donors should make a concerted effort to enhance the share of assistance that is untied and provided in the form of budget support.

4. **Enhance the counter-cyclical impact of lending from the IMF and parallel financing from the MDBs**: Responding to the perils implied by the current economic situation will require that the IFIs become more nimble, innovative and flexible to ensure that resources are mobilized quickly and used to their greatest effect.

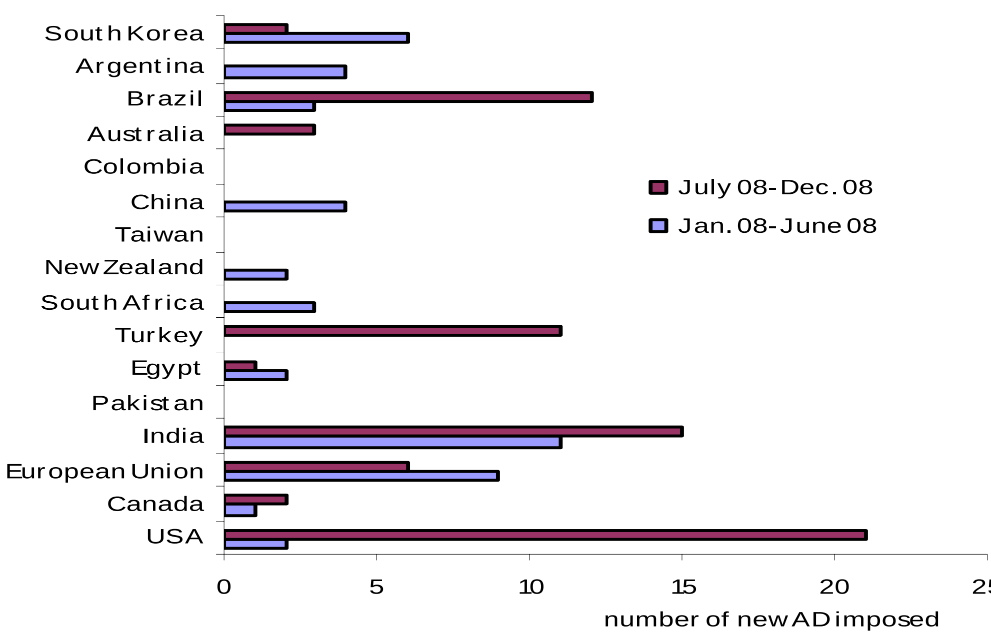
5. **Provide additional support to the private sector, particularly in emerging market economies**: With the risks of doing business having increased across the board, the official sector, through institutions like the IFC, will play an increasingly valuable role by sharing these risks. Increased collaboration and partnership between these facilities will be key to making the best use of available resources.

Annex 1: The Protectionist Tide

Protectionism remains a serious threat in the current environment. Many countries are contemplating, or have already implemented, increased protection, which may be difficult to reverse and will slow the recovery. Since the beginning of the financial crisis, roughly 78 trade measures have been proposed or implemented, of which 66 involved trade restrictions. Of these, 47 measures were actually implemented, including by 17 of the G20. In addition, anti-dumping claims and actions increased 20 percent in 2008 relative to 2007; and 55 percent in the second half of 2008 relative to the first half of 2008.

Agricultural subsidies, not counted in these numbers, have increased automatically with the recent fall in commodity prices. In addition to changes in tariffs, nontariff barriers, such as licensing requirements and tighter application of product standards, are also being introduced. Governments are also taking measures to support specific industries through potentially trade-distorting measures, including by increasing subsidies as part of fiscal stimulus packages. While government financial support packages do not necessarily distort trade, public intervention targeted at specific export-oriented industries or competing import industries are akin to protectionism and run the risk of starting a subsidy race among nations. In addition, there is a risk that governments providing "bailouts" to domestic banks may exert pressure on those banks to use those resources within their countries rather than to provide trade finance that would go to foreign countries.

New anti-dumping measures are on the rise



Source: National sources

Endnotes

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[1] For a discussion of the origins of crisis, see Jaffe, D.M., *The U.S. Subprime Mortgage Crisis: Issues Raised and Lessons Learned*, Commission on Growth and Development Working Paper 28, June 2008.

[2] World Economic Outlook Update, International Monetary Fund, January 28, 2009

[3] The IMF's January WEO forecast for Sub-Saharan Africa predicts growth in 2009 will slow to 3.5 percent from an estimated 5.4 percent in 2008. However, there is considerable variation around this average, with several countries particularly vulnerable.

[4] There have been a few exceptions. For example, gold prices remain above their historical average, reflecting, in part, the status of gold as a haven in times of turmoil.

[5] See, for example, *Double Jeopardy: Responding to High Food and Fuel Prices*, World Bank, 2008.

[6] For countries that had previously been subsidizing food and fuel prices, this will provide a welcome respite. That said, the net impact on the terms of trade of the respective declines in commodity prices is still expected to be negative in 2009 for between 25 and 30 LICs.

[7] Bower, Geis and Winkler (2007) report that between 1999 and 2005, at least 10 West and Central African countries experienced terms of trade declines of at least 10 percent.

[8] Marinkov and Burger, "The Various Dimensions of Commodity Dependence in Africa", South African Journal of Economics, Volume 73:2, June 2005

[9] Kumah, F. and J. Matovu, "Commodity Price Shocks and the Odds on Fiscal Performance: a Structural VAR Approach", IMF Working Paper WP/05/171, August 2005

[10] Vladkova-Hollar, I. and Jeronim Zettelmeyer, "Fiscal Positions in Latin America: Have They Really Improved?" IMF Working Paper 08/173; May 1, 2008

[11] In Africa, as a result of a drying up in trade finance, there has been an increased use of "cash in advance" transactions.

[12] Dealogic is a leading provider of global investment banking analysis and systems and one of the few sources of information on trade finance developments.

[13] Trade finance data reported by Dealogic covers structured trade finance operations such as syndicated loans or commodity trade finance operated by banks. It does not include private bilateral deals which actually make up the bulk of the estimated US$2.8 trillion of trade finance.

[14] Institute for International Finance, *Capital Flows to Emerging Market Economies*, January 27, 2009. these estimates are consistent with an assumption for 2009 global growth of -1.1 percent, considerably more pessimistic than the recent IMF WEO forecast of 0.5 percent. The IIF's increased pessimism concentrated in their forecasts for Latin American and Emerging Europe growth in 2009.

[15] Ghana and Kenya recently postponed planned sovereign bond issues totaling US$800 million.

[16] World Bank (2009) "The Role of Employment and Earnings for Shared Growth: The Case of Rwanda."

[17] Ratha, 2009, low-case scenario.

[18] World Bank (2009) *Simulation of the impact of reduced migrant remittances on poverty in Tajikistan*, 2009.

[19] World Bank (2009) *Bulgaria, The impact of the Financial Crisis on Poverty*, World Bank (2009) *Armenia, Implications of Global Financial Crisis for Poverty.*

[20] World Bank (2008) *Rising food and fuel prices: risks to future generations*

[21] As measured by a country's ability to manage the budget process, design and implement policies, provide services, and deliver accountable and transparent government as well as capacity to quickly enhance support for poverty reduction programs

[22] Excludes banking sector support measures.

[23] The classification of a country as "vulnerable" is based on an assessment of its overall level of exposure to the fallout from the crisis and its government's ability to cushion the impact of the crisis on exposed households. The capacity of governments to cope with the impacts of the crisis on poverty depends on: (1) fiscal capacity to incur an increased fiscal deficit (i.e., which is linked to the ability to raise additional funding domestically and from abroad without jeopardizing macroeconomic stability or debt sustainability); and (2) institutional capacity to implement programs aimed at mitigating the poverty impact of the crisis.

[24] World Bank/PREM, *Weathering the Storm: Economic Policy Responses to the Financial Crisis*, November 2008, available at http://siteresources.worldbank.org/NEWS/Resources/weatheringstorm.pdf

[25] For example, see Jorge Arbache and John Page, *More Growth or Fewer Collapses? A New Look at Long Run Growth in Sub-Saharan Africa*, World Bank Policy Research Working Paper No.WPS4384, November 11, 2007. The authors find that, for instance, child mortality rises during growth decelerations, but hardly falls during accelerations. Primary school completion rates are substantially lower in countries experiencing growth decelerations, as is life expectancy.

[26] Beck, Thorsten; Demirguc-Kunt, A., Martinez, P., and Maria Soledad, *Bank Financing for SMEs Around the World: Drivers, Obstacles, Business Models, and Lending Practices*, World Bank Policy Research Working Paper No. 4785, November 2008

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Sixty-third sessions
Agenda item 48
Follow-up to and implementation of the outcome of the 2002 International Conference on Financing for Development and the preparation of the 2008 Review Conference

Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system

Note by the President of the General Assembly

1. The outbreak of the financial crisis in 2008 originated in the advanced developed countries, but has spread quickly to become a world economic crisis that affects all countries, including the emerging economies and less developed countries.

2. To review the workings of the global financial systems and to explore ways and means to secure a more sustainable and just global economic order, I have convened a Commission of Experts, chaired by Professor Joseph Stiglitz, 2001 Nobel laureate Prize winner in Economics, and comprised of a outstanding economists, policy makers, and practitioners drawn from Japan, Western Europe, Africa, Latin America, South and East Asia. These experts were chosen based on their comprehensive understanding of the complex and interrelated issues raised by the workings of the financial system. The Commissioners are also individuals recognized for their strong grasp of the strengths and weaknesses of existing multilateral institutions as well as their sensitivity to the particular challenges facing countries from different regions of the world and at different levels of economic and social development.

3. I now have the pleasure to transmit the preliminary recommendations of the Commission for your consideration. These recommendations and the analysis that underlies them will figure prominently in the interactive thematic dialogue on "The World Financial and Economic Crisis and its Impact on Development", which I will convene from 25 to 27 March 2009 at United Nations Headquarters in New York. It is my hope that Members of the General Assembly will find these recommendations, and the dialogue next week, useful as they prepare for the United Nations Conference on World Economic and Financial Crisis and Its Impact on Development, which will be convened in little more than two months time in accordance with General Assembly resolution 63/239 of 24 December 2008.

THE COMMISSION OF EXPERTS ON REFORMS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

Recommendations
19 March 2009

I. Preamble

1. The rapid spread of financial crisis from a small number of developed countries to engulf the global economy provides tangible evidence that the international trade and financial system needs to be profoundly reformed to meet the needs and changed conditions of the 21st century. Past economic crises have had a disproportionate adverse impact on the poor, who are least able to bear these costs and that can have consequences long after the crisis is over.

2. While it is important to deal with the structural changes to adapt the international system to prevent future crisis, this cannot be achieved without significant measures to promote recovery from the current crisis whose impact may be even worse than in the past. The International Labour Organization estimates that the rise in unemployment in 2009 compared to 2007 of 30 million could reach more than 50 million if conditions continue to deteriorate. Some 200 million people, mostly in developing economies, could be pushed into poverty if rapid action is not taken to counter the impact of the crisis on developing countries. Even in some advanced industrial countries, millions of households are faced with the threat of losing their homes and access to health care, while economic insecurity and anxiety is increasing among the elderly as they lose their life-time savings in the collapse of asset prices.

3. The welfare of developed and developing countries is mutually interdependent in an increasingly integrated world economy. *Short term measures to stabilize the current situation must ensure the protection of the world's poor, while long term measures to make another recurrence less likely must ensure sustainable financing to strengthen the policy response of developing countries.* Without a truly inclusive response, recognizing the importance of all countries in the reform process, global economic stability cannot be restored, and economic growth, as well as poverty reduction worldwide will be threatened.

4. This inclusive global response will require the participation of the entire international community; it must encompass more than the G-7 or G-8 or G-20, but the representatives of the entire planet, from the G-192. It was to respond to this need that the President of the General Assembly created the present Commission of Experts to address the measures needed to meet the crisis and recommend longer term reforms. Recognising work being undertaken by the G-8 and the G-20, and other

bodies, the Commission sees its own work as complementary, seeking to focus on impacts of the crisis and responses to the crisis on poverty and development.

5. Reform of the International system must have as its goal the better functioning of the world economic system for the global good. This entails simultaneously pursuing long term objectives, such as sustainable and equitable growth, the creation of employment in accordance with the “decent work” concept, the responsible use of natural resources, and reduction of greenhouse gas emissions, and more immediate concerns, including addressing the challenges posed by the food and financial crises. As the world focuses on the exigencies of the moment the long standing commitments to the achievement of the Millennium Development Goals and protecting the world against the threat of climate change must remain the overarching priorities; indeed, appropriately designed global reform should provide an opportunity to accelerate progress toward meeting these goals.

II. Responding to the Global Financial Crisis

6. Sustainable responses to the crisis require identifying the factors underlying the crisis and its rapid spread around the world. Loose monetary policy, inadequate regulation and lax supervision interacted to create financial instability. The results were manifest in the large global imbalances whose disorderly unwinding in the absence of prompt countercyclical measures may aggravate the crisis.

7. Part of the reason for inadequate regulation was an inadequate appreciation of the limits of markets—what economists call “market failures.” While such failures arise in many markets, they are particularly important in financial markets and can have disproportionately large consequences as they spill over into “real” economic activity.

8. The conduct of monetary policy can be traced in part to an attempt to offset an insufficiency of global aggregate demand, aggravated by increasing income inequality within most countries. Monetary conditions were also influenced by the accumulation of foreign exchange reserves by some emerging market countries seeking protection from global instability and onerous conditions traditionally attached to assistance from the multilateral financial institutions.

9. The current crisis reflects problems that go beyond the conduct of monetary policy and regulation of the financial sector. It also involves deeper inadequacies in areas such as corporate governance and competition policies. Many of these failings, in turn, have been supported by a flawed understanding of the functioning of markets, which also contributed to the recent drive towards financial deregulation. These views have been the basis for the design of policies advocated by some of the international economic institutions, and for much of the architecture of globalization.

10. More generally, the current crisis has exposed deficiencies in the policies of some national authorities and international institutions based on previously fashionable economic doctrines, which held that unfettered markets are, on their own, quickly self-correcting and efficient. Globalization too was constructed on these flawed hypotheses; and while it has brought benefits to many, it has also enabled defects in one economic system to spread quickly around the world, bringing recessions and impoverization even to developing countries that have developed good regulatory frameworks, created effective monetary institutions, and succeeded in implementing sound fiscal policies.

11. The Principles and Recommendations outlined in this Report seek to address the underlying problems. They focus both on feasible interim steps that can and should be taken immediately, and the deeper medium and longer term reforms that are necessary if we are to make another such crises less likely, and if we are to strengthen the international community's capacity to respond to a crisis, should one occur.

12. In analyzing appropriate national and global responses to the crisis, the Commission noted the following principles:

13. Failure to act quickly to address the global economic downturn inevitably would increase its depth and duration and the eventual cost of creating a more balanced robust recovery.

14. In a globally integrated world, the actions of any one country have effects on others. Too often these *externalities* are not taken into account in national policy decisions. Developed countries in particular need to be aware of the adverse consequences of these externalities, and developing countries need frameworks to help protect themselves from regulatory and macro-economic failures in systemically significant countries.

15. Developing countries should have expanded scope to implement policies and create institutions that will allow them to implement appropriate counter-cyclical policies.

16. Advanced industrial countries should observe their pledges not to undertake *protectionist* actions, and even more importantly insure that stimulus packages and recovery programs do not further distort the economic playing field and further increase global imbalances.

17. Measures to restore domestic financial markets in developed countries through *subsidies* to financial institutions have been accompanied by a sharp reduction in flows of capital to developing countries. It is important to ensure that these measures do not create a new form of financial protectionism. Financial subsidies can be just as detrimental to the efficiency of a free and fair trading system as tariffs. Indeed, they

may be far more inequitable, because rich countries have more resources to support subsidies.

18. Greater transparency on the part of all parties in responding to the crisis is necessary. More generally, democratic principles, including inclusive participation in decision making, should be strengthened and respected.

19. The crisis is, in part, a result of excesses in deregulation of financial markets and in international trade. Restoring the global economy to health will require restoring a balance between the role of the market and the role of the state.

20. In responding to this crisis, it is imperative that actions to improve conditions in the short term do not result in structural changes which increase instability or reduce growth in future.

21. It is essential that governments undertake reforms that address some of the underlying factors that contributed to the current economic crisis if the world is to emerge from the crisis into sustainable, balanced growth. It is not enough simply to return to the status quo *ex ante.*

22. Appropriately designed short run measures may be complementary to long term goals, especially those related to climate change and the environment.

III. Immediate Measures

23. The current crisis must be met with rapid and effective measures, but it must also lay the basis for the long-run reforms that will be necessary if we are to have a more stable and more prosperous global economy and avoid future global crises.

24. Ten immediate measures are essential for global recovery.

1. All developed countries should take strong, coordinated, and effective actions to stimulate their economies.

25. Stimulus should be timely, have large "multipliers," help address the strains posed by the economic downturn on the poor, help address long run problems and prevent instability. While the decision on stimulus is national, it should be judged on its *global impacts;* if each country looks only at the national benefits versus costs, e.g. an increased national debt, the size of the global stimulus will be too small, spending will be distorted, and the global impact will be eviscerated.

26. *National stimulus packages should thus include spending measures to be undertaken in developing countries to offset the impact of the decline in world trade and financial market disintermediation. Industrialised countries should thus dedicate 1.0 per cent*

of their stimulus packages, in addition to traditional official development assistance commitments.

2. **Developing countries need additional funding**

27. More permanent and stable sources of funding for developing countries (See Section IV.10 below) that could be activated quickly and are not subject to inappropriate conditionality are necessary. Indeed, additional funding would be required just to offset the imbalances and inequities created by the massive stimulus and bail-out measures introduced in advanced industrialised countries. Such funding could be provided by an issuance of Special Drawing Rights approved by the IMF Board in September 1997 through the proposed Fourth Amendment of the Articles of Agreement to double cumulative SDR allocations to SDR 42.8 billion and through the issuance of additional SDRs through standard procedures.

28. In addition regional efforts to augment liquidity should be supported. For instance, extension of liquidity support under the Chiang Mai initiative without an IMF program requirement should be given immediate consideration. Regional cooperation arrangements can be particularly effective because of a greater recognition of cross-border externalities and greater sensitivities to the distinctive conditions in neighbouring countries.

29. These additional sources of funding should be in addition to traditional official development assistance. Failure to maintain the levels of official assistance will have long-term effects. There will be an increase in poverty and malnutrition and the education of many young people will be interrupted, with life-long effects. The sense of global social solidarity will be impaired, making agreement on key global issues, such as responding to the challenges of climate change, more difficult. Failure to provide such assistance can be counterproductive even in a more narrow sense: it can impair the global recovery.

30. *Developed countries must make a renewed effort to meet the commitments made in the Millennium Declaration, the Monterrey Consensus, the 2005 Global Summit, and the Doha Declaration by 2015.*

3. **Mobilizing Additional Development Funds by the Creation of a New Credit Facility**

31. The creation of a new credit facility is thus a matter of urgency. If such a facility could be created in a timely way, it could be a major vehicle for the disbursement of the requisite additional funding.

32. Given the need for rapid response, the new credit facility might be more quickly established under the umbrella of existing institutions, such as the World Bank, where

efforts are underway to remedy existing inadequacies in governance and lending practices, or in Regional Development Banks where developing countries have more equitable representation.

33. Or alternative institutional arrangements that create competition amongst institutions providing financial assistance might be envisaged. Such competition might not only increase the efficiency of disbursement, but also reduce the application of procyclical conditionality linked to financial support.

34. Whatever form is chosen, the new facility should have governance more reflective of democratic principles, with strong representation of developing countries and those countries contributing to the facility. These new governance arrangements might provide lessons for the reform of existing institutions.

35. Administration of the Facility could be done by staff seconded from existing multilateral financial institutions or central banks. The new facility could draw upon financial contributions from all countries. It could leverage any equity funds contributed by borrowing, including on the market or from those with large reserves or Sovereign Wealth Funds. Its ability to borrow could be enhanced through guarantees provided by governments, especially those of the advanced industrial countries. These alternative arrangements should be seen as a complement to expanded financial support from existing institutions,

4. Developing Countries need more policy space

36. There are asymmetries in global economic policies—countercyclical policies are pursued by developed countries, while most developing countries are encouraged or induced to pursue pro-cyclical policies. While this is partly due to the lack of resources to pursue countercyclical policies, it is also due to misguided policy recommendations from international financial institutions. Conditionality attached to official lending and support for international financial institutions has often required developing countries to adopt the kinds of monetary and regulatory policies which contributed to the current crisis. In addition, these conditionalities contribute to global asymmetries, disadvantage developing countries relative to the developed, and undermine incentives for developing countries to seek support funding, contributing to global economic weakness. While the IMF initiatives to reduce conditionalities are to be commended, they might be insufficient, while in many cases countries are still required to introduce pro-cyclical policies.

5. The lack of coherence between policies governing trade and finance must be rectified.

37. Policy space is circumscribed not only by a lack of resources, but also by international agreements and by the conditionalities that often accompany assistance.

Many bilateral and multilateral trade agreements contain commitments that circumscribe the ability of countries to respond to the current crisis with appropriate regulatory, structural, and macro-economic reforms and rescue packages, and may have exposed them unnecessarily to the contagion from the failures elsewhere in the global economic system. *Developing countries especially need policy frameworks that can help protect them from regulatory and macro-economic failures in systemically significant countries.* Developing countries have had imposed on them not only deregulation policies akin to those that are now recognized as having played a role in the onset of the crisis, but also have faced restrictions on their ability to manage their capital account and financial systems (e.g. as a result of financial and capital market liberalization policies); these policies are now exacting a heavy toll on many developing countries.

6. Crisis response must avoid protectionism

38. Overt protectionism includes tariffs and domestic restrictions on procurement contained in some stimulus packages. Because of complex provisions and coverage of international trade agreements, seemingly "symmetric" provisions (e.g. exceptions of the application of provisions to countries covered by particular WTO or other international agreements) can have markedly asymmetric effects. Subsidies, implicit and explicit, can, as has been noted, be just as distorting to open and fair trade. There may, in some cases, be pressure for banks receiving large amounts of government assistance to focus on lending domestically. While the temptation that gives rise to such measures is understandable, efforts need to be made to finance additional support to developing countries to mitigate the impact of the crisis as well as of both open and hidden subsidies (i.e. state assistance through lending programs and guarantees) in order to avoid further distortions.

7. Opening advanced country markets to least developed countries' exports

39. While a successful completion of the Doha trade round would be welcome, its impact on the crisis and its development dimension are still unclear (see IV.9, below). There are, however, a number of measures that have already been agreed in multilateral trade negotiations which could be implemented rapidly to support developing countries impacted by the crisis. These include implementation of duty-free, quota-free market access for products originated from LDCs. In addition, the agreement reached at the WTO´s Hong Kong Ministerial session in 2005 provided for the elimination of all forms of developed country export subsidies, at the latest by 2013, should be implemented immediately. There is no reason to await a general agreement before implementing these measures. In addition, domestic support for cotton subsidies should be abolished immediately, as they distort prices to the detriment for African countries. More generally, in all trade negotiations, the long recognized principle of special and differential treatment of developing countries should be preserved.

8. Learning from Successful Policies to undertake Regulatory Reforms.

40. The financial crisis is widely viewed to be the result of the failure of regulatory policies in the advanced industrial countries. While full regulatory reforms (discussed more extensively in section IV.6 below) will take time, it is imperative that work on regulatory reform begin now. The collapse in confidence in the financial system is widely recognized as central in the economic crisis; restoration of confidence will be central in the recovery. But it will be hard to restore confidence without changing the incentives and constraints facing the financial sector. *It is imperative that the regulatory reforms be real and substantive, and go beyond the financial sector to address underlying problems in corporate governance and competition policy, and in tax structures, giving preferential treatment to capital gains, that may provide incentives for excessive leverage.* While greater transparency is important, much more is needed than improving the clarity of financial instruments. Even if there had been full disclosure of derivative positions, their complexity was so great as to make an evaluation of the balance sheet position of the financial institutions extraordinarily difficult. Still, there is need for much greater transparency, including forbidding off balance sheet transactions and full expensing of employee stock options.

41. Well regulated economies have to be protected from competition from economies with inadequate or inappropriate regulatory systems. The problems of regulatory arbitrage and tax evasion are closely linked. Tax havens and financial centers in both developed and developing countries *that fail to meet basic standards of transparency, information exchange and regulation should be given strong incentives to reform their practices*, e.g. by restricting transactions between financial institutions in those jurisdictions and those in more highly regulated countries. Institutional arrangements for improving harmonisation and transparency should be strengthened, including the United Nations Committee of Experts on International Cooperation in Tax Matters as proposed in Paragraph 16 of the Doha Declaration. Also other international arrangements and conventions such as United Nations Convention against Corruption should also be strengthened.

9. Coordinating the Domestic and Global Impact of Government Financial Sector Support

42. Government bail-outs have substantial redistributive consequences that must be analysed in assessing their impact on recovery. In addition, because of the urgency of the situation they often fail to observe principles of good governance and especially of democratic transparency. This may lead to the introduction of inappropriate incentives, as well as failure to recognise possible adverse effects on other countries, especially on developing countries that lack equivalent financial resources.

Developed countries should undertake their financial support policies recognising that even symmetric policies can have asymmetric effects because guarantees by developing country governments are likely to be less meaningful than those by developed countries.

43. Failure to recognise these wider domestic and global consequences of financial support measures have often meant that the costs to the government and to developing countries have been higher than necessary. Funds have often been redistributed to those with higher incomes, and have created distorted incentives. Support measures for financial institutions that are implemented by Central Banks risk imposing high costs on the public purse, without adequate parliamentary oversight of appropriations. *Greater transparency on the part of all parties would facilitate a more effective response to the crisis.*

10. Improved coordination of global economic policies

44. There is a need for substantial improvement in the coordination of global economic policy. Global economic integration has outpaced the development of the appropriate political institutions and arrangements for governance of the global economic system. Remedying this lacuna is a matter of urgency, discussed at greater length in section IV.3, but this will not happen overnight.

45. In the short term, there should be an appropriate mechanism within the United Nations System for independent international analysis on questions of global economic policy, including its social and environmental dimensions. Following the successful example of the Intergovernmental Panel on Climate Change (IPCC), a similar panel could be created to offer consultancy to the General Assembly and ECOSOC, but also to other international organizations to enhance their capacity for sound decision-making in these areas. At the same time, such a panel would contribute to foster a constructive dialogue and offer a regular venue for fruitful exchange between policy makers, the academic world and key international organisations. The panel should comprise well respected academics from all over the world, appropriately representing all continents, as well as representatives of international social movements. Being made up of outstanding specialists, the panel should be able to follow, analyse and assess long-term trends, key developments and major dynamics for global change affecting all people around the globe, identify problems in the global economic and financial architecture, and jointly provide options for coherent international action and recommendations for political decision-making processes.

IV. Agenda for Systemic Reforms

46. There is an equally important agenda of deeper systemic reforms to the international system, that should begin now, if we recovery is to be sustainable.

1. A New Global Reserve System

47. The global imbalances which played an important role in this crisis can only be addressed if there is a better way of dealing with international economic risks facing countries than the current system of accumulating international reserves. Indeed, the magnitude of this crisis and the inadequacy of international responses may motivate even further accumulations. Inappropriate responses by some international economic institutions in previous economic crises have contributed to the problem, making reforms of the kind described here all the more essential. To resolve this problem ***a new Global Reserve System***—what may be viewed as a greatly expanded SDR, with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations—could contribute to global stability, economic strength, and global equity. Currently, poor countries are lending to the rich reserve countries at low interest rates. The dangers of a single-country reserve system have long been recognized, as the accumulation of debt undermines confidence and stability. But a two (or three) country reserve system, to which the world seems to be moving, may be equally unstable. The new Global Reserve System is feasible, non-inflationary, and could be easily implemented, including in ways which mitigate the difficulties caused by asymmetric adjustment between surplus and deficit countries.

2. Reforms of the Governance of the International Financial Institutions

48. There is a growing international consensus in support of reform of the governance, accountability, and transparency in the Bretton Woods Institutions and other non-representative institutions that have come to play a role in the global financial system, such as the Bank for International Settlements, its various Committees, and the Financial Stability Forum. These deficiencies have impaired the ability of these institutions to take adequate actions to prevent and respond to the crisis, and have meant that some of the policies and standards that they have adopted or recommended disadvantage developing countries and emerging market economies. Major reforms in the governance of these institutions, including those giving greater voice to developing countries and greater transparency are thus necessary.

49. The reform of the World Bank's governance structure should be completed swiftly. For the second stage of the reform, focussing on the realignment of shares, three criteria could be taken into account: economic weight, contribution to the development mandate of the World Bank (for example, measured in terms of contributions to IDA and trust funds), and the volume of borrowing from the Bank.

50. For the IMF, serious consideration should be given to restoration of the weight of basic votes and the introduction of double or multiple majority voting.

51. Elections of the leaders of the World Bank and the International Monetary Fund should take place under an open democratic process.

3. A Global Economic Coordination Council.

52. A globally representative forum to address areas of concern in the functioning of the global economic system in a comprehensive way must be created. At a level equivalent with the General Assembly and the Security Council, such a Global Economic Council should meet annually at the Heads of State and Government level to assess developments and provide leadership in economic, social and ecologic issues. It would promote development, secure consistency and coherence in the policy goals of the major international organisations and support consensus building among governments on efficient and effective solutions for issues of global economic, governance. Such a Council could also promote accountability of all international economic organizations, identify gaps that need to be filled to ensure the efficient operation of the global economic and financial system, and help set the agenda for global economic and financial reforms. It would be supported intellectually by the work of the International Panel discussed in III.10. Representation would be based on the constituency system, and designed to ensure that all continents and all major economies are represented. At the same time, its size should be guided by the fact that the council must remain small enough for effective discussion and decision making All important global institutions, such as the World Bank, IMF, WTO, ILO and members of the UN Secretariat dealing with economic and social issues would provide supporting information and participate in the Council. It could thus provide a democratically representative alternative to the G-20.

4. Better and more balanced surveillance.

53. The surveillance of economic policies should be especially focused on systemically significant countries, those whose bad performance is most likely to have global consequences. Such surveillance should focus not just on inflation, but on unemployment, financial stability, systemic stability related to the presence of built in stabilizers or destabilizers, and systems of social protection.

5. Reforming Central Bank Policies to promote Development

54. Whereas price stability is desirable in support of growth and financial stability, it is not sufficient. Central Banks should therefore aim to ensure price stability in the context of delivering long-term sustainable growth, while being sensitive to the risks to financial stability, capital flows and exchange rates. Central banks also need to give consideration to financial market and asset price developments. This may entail Central Banks using a wider range of instruments, including prudential instruments. A distinction may need to be made between the roles of Central Banks in maintaining financial stability under normal circumstances and during crisis periods. Central

Bank governance arrangements may need to differ depending on their precise role. In particular, in any actions which may impose serious risks on a country's fiscal position, such as those now being implemented in many countries as part of financial institution resolutions, should be subject to coordination.

6. Financial Market Policies

55. Financial policies, including regulation, have as their objective not only ensuring the safety and soundness of financial institutions and stability of the financial system, but protection of bank depositors, consumers and investors and ensuring financial inclusion - such as access to all banking services including credit, and the provision of financial products which help individuals and families manage the risks they face and gain access to credit at reasonable terms. It is also imperative to make sure that the sector is competitive and innovative.

56. Financial institutions have been allowed to grow to be too big to fail, imposing enormous risk on the global economy. And while there has been innovation, too much of the innovation was aimed at regulatory, tax, and accounting arbitrage, and too little at meeting the real needs of ordinary citizens. Too little was done to help developing countries and ordinary homeowners manage the risks which they face, with consequences that have been repeatedly apparent. Financial regulation must be designed so as to enhance meaningful innovation that improves risk management and capital allocation.

57. The current crisis has made it apparent that there are large gaps and deficiencies in the regulatory structures in place in many systemically significant countries. It is also apparent that while effective regulatory system must be national there must be some global regulatory framework to establish minimum national standards and also govern the global operations of systemical relevant global financial institutions. The Report of the Commission will identify a number of key aspects of regulatory reform, emphasizing the need for deep and pervasive reforms and highlighting the risks of merely cosmetic changes in regulations. The following items are among the key aspects of needed reform.

(*a*) *Financial Product Safety*

58. Sustainable recovery will depend on appropriate regulations (across countries, products, and institutions). Regulations should be based on what things are, not what they are called, i.e. insurance products should be regulated the same way, whether called insurance or not. Financial regulators should be mandated to ascertain the safety and appropriate use of various financial instruments and practices, including through the creation of a Financial Products Safety Commission.

59. Core depository institutions should be restricted from undertaking excessively risky activities and tightly regulated. There also needs to be close oversight over all highly levered and all systemically significant institutions. But there should be oversight over all financial institutions. Institutions can quickly change into systemically significant.

(*b) Comprehensive Application of Financial Regulation*

60. The fact that correlated behavior of a large number of institutions, each of which is not systemically significant, can give rise to systemic vulnerability makes oversight of all institutions necessary. There needs to be tighter regulation of incentives, especially in the core institutions; part of the current problem is a result of distorted incentives which encouraged short sighted and excessively risky behavior. It may be easier to regulate incentives than every manifestation of perverse incentives. There need to be restrictions on leverage, with automatic countercyclical capital adequacy and/or provisioning requirements.

61. Although the activities of private investment funds, equity funds and hedge funds did not trigger the financial crisis, their regulation is not globally uniform, creating the potential for regulatory arbitrage and the potential for gaps in regulation. Funds should be registered in the countries of their operations and provide appropriate regulation to regulatory authorities. In addition, banks must define limits for transactions with hedge funds.

62. There should be no retreat from mark to market accounting for institutions with short-term funding in order to provide full transparency for investors and regulators. Other institutions may be encouraged to supplement mark-to-market accounting with valuations that are more appropriate to the maturity of their liabilities. In addition, steps should be taken to enforce transparency norms and public accountability for all public companies.

(*c) Regulation of derivatives trading*

63. The large scale use of unregulated, unsupervised OTC derivatives has resulted in undue complexity, opacity, and mis-pricing of these instruments, and facilitated capital avoidance by financial institutions. These practices have weakened our financial system significantly and made resolution of failing firms extremely difficult.

64. Where appropriate steps should be take to develop regulated exchanges for trading standardized contracts of systemically significant derivative contracts, with the associated regulatory restrictions including limits on non-commercial traders. Regulations should insure that derivative instruments are held on balance sheets, valued at independently audited real transaction prices, with appropriate capital provisioning, and clarity of purpose. The use of over the counter contracts by core

institutions should, in general, be discouraged, but whenever used, there should be ample and adequate margin.

(*d) Regulation of Credit Rating Agencies*

65. Other needed reforms, including for Credit Rating Agencies and systems of information provision are addressed in an Appendix.

(*e) Towards global institutional arrangements for governing the global economy: a Global Financial Regulatory Authority; a Global Competition Authority.*

66. The Financial Stability Forum was created in the aftermath of the 1997-8 financial crisis in order to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to propagate from country to country, and to enhance the institutional framework to support global financial stability. It is now apparent that the reforms that it has proposed, although important, have not been sufficient to avoid major global financial instability. If it is to become the main instrument for the formulation of reforms of the global financial system it must take into consideration the importance of financial stability for the development of the real economy. In addition it must increase the representation of developing countries to adequately reflect the views and conditions in these countries and be made accountable to a democratically representative institution such as the Global Economic Coordination Council proposed above.

67. The development of financial institutions that are too big to fail has played an important role in the development of the crisis and has made the resolution of the crisis both difficult and costly, both for taxpayers and for the global economy. It is imperative not only that is adequate oversight of these large institution but that efforts be made to limit their size and the extent of their interactions, to limit the scope of systemic risk. This will require more effective global cooperation in financial and competition regulation. Movement towards this goal might be enhanced by taking steps to lay the groundwork for a Global Financial Regulatory Authority and a Global Competition Authority. With so many firms operating across borders, it is difficult to rely on national regulatory authorities. There may be large externalities generated by the action (or inaction) of national authorities. A potential, but partial, remedy to this difficulty is the proposal for a College of Supervisors to oversee systemically relevant global financial institutions. This could provide a basis for a more comprehensive Global Authority.

(*f) Host Country regulation of foreign subsidiaries*

68. In the absence of adequate global coordination, financial sector regulation will need to be based on the host country, not the home country, and may entail requiring the establishment of subsidiaries, rather than relying on branches.

(*g*) *Regulatory institutions*

69. While inadequate regulations are partly to blame for the current crisis, in some cases good regulations were not effectively applied and enforced. This highlights the need for reforms in regulatory structures, including reforms that make the possibility of regulatory capture less likely. The weaker is the system of global regulation, the more segmented will financial markets have to be to ensure global stability.

7. Support for Financial Innovations to Enhance Risk Mitigation

70. The absence of global systems of risk bearing and the absence of—and in some cases resistance to—innovations that would facilitate efficient risk bearing, such as GDP indexed bonds and mortgage products which better manage the risks associated with home ownership must be remedied. Governments and the international financial institutions need to explore meaningful innovations that would enhance risk management and distribution and how markets might be encouraged to do a better job. In particular, while there have been some expansion in capital markets in domestic currencies in developing countries, developing countries still bear the brunt of exchange and interest rate fluctuations. IFI lending in (possibly baskets of) local currencies and the provision of exchange and interest rate cover might be important steps in improving international risk markets.

8. Mechanisms for handling Sovereign Debt Restructuring and Cross-border Investment Disputes

71. There is an urgent need for renewed commitment to develop an equitable and generally acceptable Sovereign Debt Restructuring Mechanism, as a well as an improved framework for handling cross border bankruptcies. One way by which this might be done is through the creation of an independent structure, such as an International Bankruptcy Court. The United Nations Commission on International Trade Law provides a model that could be extended to the harmonization of national legislation on cross border disputes dealing with trade in financial services.

72. A number of countries may face difficulties in meeting their external debt commitments as the crisis worsens and debt rescheduling becomes more and more difficult due to an increase in creditors not represented in the Paris Club. The current crisis has already seen a number of bankruptcies of companies that operate across national borders, and their number is likely to increase. The absence of a formal mechanism for dealing with the impact of cross border bankruptcy and insolvency,

especially when related to financial institutions, transmits the adverse economic effects to the global economy.

73. It is especially important to achieve a uniform approach to financial and investment disputes on bankruptcy and insolvency, given the fact that the regulations dealing with these matters included in bilateral free trade agreements often transcend existing multilateral treaties and national legislation.

9. Completion of a Truly Development-Oriented Trade Round

74. There is a need for a true development round, to create an international trade regime which truly promotes growth in the developing countries. It is essential, that in all trade negotiations, the long recognized principle of special and differential treatment of developing countries be preserved.

10. More Stable and Sustainable Development Finance

75. The need for more and more stable sources of finance for development, including for the investments needed to address the long run challenges of responding to climate change, and new institutions for disbursement of funds, is discussed in Section III.4 above.

76. In the absence of better systems of risk mitigation, it is especially important for developing countries to be wary of measures that expose them to greater risk and volatility, such as capital market liberalization. Developing countries should use all the tools at their disposal, price interventions, quantitative restrictions, and prudential regulations, in order to help manage international capital flows.

77. Market-driven international capital flows are of a magnitude and volatility that they can offset any formal mechanism to provide additional finance for development. Thus, an active management of foreign capital inflows will be required to ensure that they are supportive of government counter-cyclical policies. The Articles of Agreement of the International Monetary Fund provided to members the facility of controlling capital inflows and expressly excluded the use of Fund resources to meet imbalances resulting from capital account disequilibrium. The Fund should thus be encouraged to return to its first principles and support countries that attempt to manage external flows in support domestic counter cyclical policy.

78. The international community needs to explore a variety of mechanisms of ***innovative finance,*** including regular emissions of a new global reserves (SDRs), revenues generated from the auction of global natural resources (such as ocean fishing rights and pollution emission permits), and international taxes (such as a carbon tax, which would simultaneously help address problems of global warming, or a financial

services tax, which would simultaneously help stabilize international financial markets.)

79. The receipts could be directed to support the developing countries costs of reducing greenhouse gas emissions in the context of their national policies to promote sustainable development. The effective implementation of national systems of taxation form a crucial part of domestic development finance. Measures must be taken to preserve national autonomy in the selection of the sources and methods of government financing while ensuring that national differences do not create incentives to evade responsibility of contributors to the support of government policies. An efficient method of achieving this result would be the acceptance by all countries of an amendment of Article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries to make the exchange of information automatic.

Information on the Commission of Experts is available in: http://www.un.org/ga/president/63/commission/financial_commission.shtml.

25 March 2009

**Statement of Mr. Miguel d'Escoto Brockmann,
President of the 63rd Session of the General Assembly,
at the Opening Session of the Interactive Thematic Dialogue on the Financial and Economic Crisis and Its Impact on Development**

Excellencies,
United Nations Colleagues,
Representatives of Civil Society,
Friends All,

I am very pleased to welcome you all to this Interactive Thematic Dialogue. Your presence marks another step in our efforts to address the financial and economic crisis and its impact on the well-being of billions of people around the world in an inclusive manner.

We have been involved in a dynamic, and ongoing, inter-governmental process to prepare the modalities for the United Nations conference at the highest level on these issues. That conference will begin in just over two months.

This morning, and over the next three days, we begin a new phase in the process of broad-based consultations to better understand the crisis and its impacts, and to deliberate on the appropriate response to this global turmoil.

Our Thematic Dialogue must be seen in the context of three summits that are scheduled in the months ahead, beginning with the G20 London Summit on 2 April; the highest-level UN Conference here at UN headquarters in June; and the G8 meeting in Italy in early July.

All of these meetings, and their concurrent preparatory processes, provide opportunities to build worldwide consensus in support of global action to address the deepening crises.

As the only forum where all 192 Member States participate on a basis of sovereign equality, according to legally defined procedures, the General Assembly has a unique role to play in fashioning a truly global and legitimate policy response to the crisis. It is urgent and vital that this body, the United Nations General Assembly, live up to its responsibilities to assure that all of human kind, and the fate of our planet, are taken into account in developing a coordinated, coherent and effective approach.

We have structured a series of panels to analyze the causes of the crisis, its multifarious impacts on people and the real economy, and the nature and adequacy of the global policy responses to date.

We urgently need concrete action to address and contain the complex breakdown that continues to unfold around us, measures to mitigate the potentially disastrous impacts on many millions of our most vulnerable brothers and sisters – who bear no responsibility for this crisis and who have no voice in the established policy-making processes outside of the United Nations.

We need to understand and draw upon the resources currently available to us in the first line of response. Today, I am very pleased that we will take an in-depth look at the world's most powerful resource for global policy response and effective action – our own United Nations system.

This morning's session will draw upon the excellent analytical resources of our own Department of Economic and Social Affairs, the International Labor Organization, and the Regional Commissions to analyze the origins and dynamics of the crisis, its many modes of transmission and its impacts on the real economy, and the nature of the policy response in each of the regions.

I am delighted that this afternoon's panel on UN System Responses to the crisis will allow us to take a holistic look at four of the UN system's most powerful institutions for fashioning and implementing a global policy response: the United Nations Conference on Trade and Development, the United Nations Development Programme, the World Bank, and the International Monetary Fund.

There is universal agreement that the current is a global crisis that demands a global response.

I believe that we can find a new spirit of universal solidarity that can meet this challenge and lead us to recovery. I believe that we can find the solidarity to work with those governments that cannot print their way out of this crisis. And, I believe that we can find the solidarity to look out for those people who are suffering most and bear the least responsibility for the downturn.

One question we must ask is whether the policy response to date, and the tools at our disposal, are adequate to the job of responding to the crisis, and, at the same time, beginning the necessary work of addressing the exposed weakness in our framework for managing the global financial, economic and trading system.

I believe that that the UN system can play a unique role in assisting the Member States in their search for and implementation of potential solutions. We know, and I believe we will get further confirmation that the UN system has the basic capacity, the expertise and the global presence to respond in significant and practical ways to the crisis.

By the same token, we must recognize that the institutions that most of the institutions we have today were created in, and designed to work for, a very different world than the one we have today. As we fashion our global response, accordingly, we keep in mind that the solutions we adopt today need to be seen in light of the significant evolution of the world economy that has taken place since 1945. We need a 21st century architecture to support a 21st century global economy that is at once dynamic, inclusive, safe for all participants, and just.

To help identify short- and longer-term opportunities both to respond to the crisis in ways that more effectively serve the needs of those without voice in global policy deliberations, and to begin the movement toward systemic reform, I have convened a Commission of Experts on Reform of the World Financial and Economic System. Under the chairmanship of Nobel laureate economist Joseph Stiglitz, 18 distinguished economists, central bankers, and practitioners from across the world have been working intensively since late last year to identify critical gaps in our policy response and in the system framework for addressing the crisis.

Last Friday, I forwarded to you their wide-ranging recommendations on the crisis. I am very pleased with the depth and coherence of the Commission's recommendations. Its chairman, Professor Joseph Stiglitz, as well as other distinguished members, will report on its work at the tomorrow morning's session.

Our panels on Thursday and Friday on the Reform of International Institutions, on the International Financial Architecture and the Re-regulating the Financial System all address particularly difficult issues. I look forward in confidence to the ideas which will be generated.

In our deliberations to prepare the modalities for the June Conference at the highest level, it is clear that the Member States are determined to take responsibility for fashioning a global response to the world-wide crisis. And so I am very pleased that several distinguished Representatives of the United Nations Member States have agreed to lead four of the five sessions we have organized over the next two and half days.

It is my pleasure now to pass the gavel to the distinguished Permanent Representative of Norway, H.E. Morten Wetland, a great friend of the United Nations and a leader in the process of revitalizing our General Assembly.

Thank you.

27 March 2009

**Statement of Mr. Miguel d'Escoto Brockmann,
President of the 63rd Session of the General Assembly,
at the Closing Session of the Interactive Thematic Dialogue on the Financial and Economic Crisis and Its Impact on Development**

Excellencies,
United Nations Colleagues,
Representatives of Civil Society,
Friends All,

As we come to the close of this Interactive Thematic Dialogue, I want to thank all of the panelists and moderators as well as the scores of Delegates who participated so constructively in this timely exchange. It is clear that all of us are aware of the urgency of the economic and financial crises that are unfolding around us. I am heartened to see that we are thinking creatively to find solutions to the myriad problems that are surfacing in this global downturn.

This three-day meeting has demonstrated once again that the Assembly, the UN system and partners from the private sector, civil society and academia can come together to identify problems and explore solutions that reflect the concerns of all Member States. This is, of course, the role of the General Assembly mandated by the United Nations Charter.

Delegates have mentioned to me that they are impressed at the range of ideas that have been put forward over the past three days. Some are even surprised by the willingness of the different stakeholders to entertain new approaches and consider alternative measures to the many now discredited ways we do business.

We have heard a series of recommendations from the Expert Commission on the Economic and Financial Crisis, which reflect the views of eminent economists from every part of the world. Their specific recommendations -- 22 in all – were ably presented by Professor Joseph Stiglitz yesterday. I am heartened to see that certain proposals, including those affecting reserve currencies and the regulation of capital flows, received support among many Delegations here. I propose that we ask the Commission members to continue to gather and analyze the complex information and global trends that will help us to make informed decisions in the months ahead.

Our work is given greater urgency as speakers emphasized the expectation that the ongoing economic turmoil is likely a prelude to increased and unpredictable political instability that will complicate the recovery even further. Unfortunately, as Professor Stiglitz pointed out, some in the recent past saw a light at the end of the tunnel. But the light turned out to come from a train speeding straight at us. We must not let this happen again.

Looking ahead, I remind you that June is quickly upon us. I am hopeful that the negotiations on modalities for the high-level UN Conference on the World Financial and Economic Crisis and Its Impact on Development in June will conclude with agreement today.

I share the sentiment expressed by many that this is a foundational moment. Echoing the appeal yesterday by one of my Commissioners, “We must be brave — we must have vision to fulfill the purposes for which this Organization was founded.”

The General Assembly, as the premier forum for global deliberation, must rise to these challenges. Certainly each Member State will and should defend its national interests, but not at the expense of the legitimate rights of others. Equally, perhaps most importantly, we must keep present our collective responsibility to be the voice of "We the peoples..." and to ensure that the common good is paramount over petty self-interests.

The world's most vulnerable are in need of the global force of the G-192 present here in this body -- this Assembly -- joined in a noble mission to defend the right of the world's most vulnerable to full participation in our global community. They can no longer be seen as scapegoats or victims, but as the legitimate stakeholders that they are. We must endeavor to ensure that relief and opportunity are not privileges reserved solely for more affluent societies, but include and prioritize our brothers and sisters in greatest need.

Ultimately, it is the role of this Assembly to ensure that all nations, great or small, rich or poor are afforded the opportunity to participate in a legally constituted and inclusive process. Shared decision-making implies power-sharing, and with power comes responsibility. The world will hold us accountable for the integrity, scope and intellectual depth of our response to the international financial and monetary crisis and its impact on development.

I am certain that together, we will find within ourselves individually and collectively, the moral strength and creativity that we as human beings possess, and the resolve to see this process through. In doing so, we must forge a new vision of our global community.

It will not be easy. If prosperity and progress are to benefit each and all of us, they can not be based on patterns of insatiable greed and consumption, but rather on sound internationally regulated financial and monetary institutions. They will flow from institutions that enable, not hinder, the formulation of inclusive and people-centered development policies; trade regimes based on principles of fairness and equity; food systems that are ecologically sound and sustainable, and that offer just reward to small-scale farmers; labor regimes that address the special needs of women as the baseline for judging economic performance.

Do I think such a world is possible? As President of the sixty-third session, I call upon each of you here today to make the construction of a new, vibrant vision of our global society a shared priority and our common endeavor.

Thank you.

INDONESIA

Please check against delivery

Extraordinary interactive thematic dialogue
General Assembly
63rd session

Intervention by
H.E. R.M. Marty M. Natalegawa
Permanent Representative of the Republic of Indonesia to the United Nations

At the Interactive Thematic Dialogue on the Financial and Economic Crisis and its Impact on Development

on

UN System Responses to the Crisis
Afternoon Session (3 – 6 pm)

New York, 25 March 2009

PERMANENT MISSION OF THE REPUBLIC OF INDONESIA TO THE UNITED NATIONS
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Mr. Moderator

As this is the first time Indonesia has taken the floor, I should like to begin by thanking the President of the General Assembly for taking the initiative in convening this dialogue. I should also like to take this opportunity to express our appreciation to the representatives of UNCTAD, UNDP, World Bank and IMF for their insightful presentations.

The financial and economic crisis is having a tremendous impact on many developing countries. As a country that experienced the 1997/98 crisis, Indonesia is all too aware of how the multifaceted nature of a financial crisis can quickly evolve to become not just an economic crisis, but also a social and political crisis. In this regard, timely and effective immediate and long term actions, using all the economic and financial tools available, are therefore critical.

For the majority of developing countries, however, this is a major challenge. Developing countries' limited financial capacity and policy space constraints have become major impediments preventing them from taking necessary measures, including important counter-cyclical policies, to deal with the crisis.

Against this backdrop, many developing countries find that their only option is to seek international assistance. The role of the UN programs and specialized agencies, supported by multilateral and regional development banks, is therefore crucial in this regard.

UN programs and specialized agencies have a comparative advantage, particularly in the area of development and humanitarian assistance. Their presence and familiarity with the economic and social structures in the majority of developing countries make them important partners well able to assist developing countries in addressing the crisis, particularly in the short term.

Indonesia would like to highlight four areas which we believe UN responses should focus on. First, there is a need for a UN response to help provide budget support financing for developing countries so they can pursue counter cyclical measures. Apart from additional financing and programs, on going country programs should be adjusted so they can function in the same way that stimulus packages would.

Second, there is a need to promote emergency support for trade financing and for support to be extended to the private sector. Many developing countries are dependent on trade. The current weak global demand, compounded by a drying up of trade finance, has contributed to the further deterioration of developing countries' economies. Effort should therefore be made towards improving effective guarantee facilities as well as direct or bridging finance. In this context, we welcome the expansion of the World Bank Global Trade Finance Program, and call on other institutions to follow suit.

Third, there must be strengthening of the provision of social safety nets. It is important that an effective social safety net provision should be put in place to help the vulnerable and the very poor in developing countries.

Fourth, ensuring efficiency in country support assistance is imperative. Minimizing the administrative costs for assistance from UN programs would help increase the size and the multiplier effect of the programs.

While the UN response is critical, the UN's ability to effectively help developing countries will be determined by budgetary constraint. In this respect, the role of ODA is critical. Developed partners need to ensure that their ODA commitment is fulfilled. Indonesia also supports the call by the World Bank to dedicate 0.7 of developed countries' planned stimulus packages for ODA.

Finally, the issue of coordination in responding to the crisis has been highlighted in many discussions as being central to maximizing the impact of actions in addressing the crisis. We see coordination of the UN system in responding to the crisis in the same light. In this regard, we welcome the Secretary General's intention to hold a UN CEB (United Nations Chief Executive Board) meeting in Paris after the G20 Summit to ensure that the UN system can act and deliver as one.

Thank you.

Speaking Notes by Ambassador Raymond Wolfe, Permanent Representative of Jamaica at the Interactive Thematic Dialogue on the Financial and Economic Crisis and its Impact on Development,
<u>26 March 2009</u>

- As the world sinks into recession resulting from the unfolding global financial crisis, it is the most vulnerable among us that will be most affected. For our part, Jamaica, as well as our other CARICOM neighbours, have already been experiencing the manifestations of the fallout in a number of critical areas including tourism, bauxite/alumina and remittances on which our economies rely heavily. Access to credit has been tightened as some are unable to access the private capital market, reduced revenue intake given the fall in global demand for commodities, and rising unemployment.

- Commend the PGA for convening the interactive dialogue on the financial and economic crisis and its impact on development as part of the preparations for the upcoming high-level Conference to be held in a few months.

- Express appreciation for the recommendations submitted by the Commission of Experts of the PGA on Reforms of the International Monetary and Financial System. Indicate that while many of the recommendations are laudable, Jamaica is currently undertaking a more detailed reviewed and will submit our views in due course. In the meantime, we wish to make a few preliminary remarks regarding priority issues to be explored as part of a wider response:

  1. **Multilateral Institutions:** As more countries are forced to exercise the option of borrowing from the multilateral institutions in the wake of the global upheaval, there is greater urgency for addressing issues of governance and greater representation of developing countries in these institutions. This issue must be accorded the greatest priority in the context of reform of the multilateral institutions.

  2. **More inclusive approach to finding solutions.** Greater participation is required in global governance and decision-making. Jamaica is of the view that this issue is of such fundamental importance that every country should be afforded an opportunity to influence the process. Having said that, we believe that other groupings have an important role to play. We note the composition of the G20, which includes some developing countries as well as some of the emerging economies. We believe that in the interest of more equitable representation, there should be opportunities for smaller developing countries to be involved in their deliberations.

3. **Situation of developing Middle Income Countries (MICs).** MICs have experienced a reduction in their aid assistance. Yet more development aid is needed, not only in relation to the burgeoning debt problem but in light of the global recession. Jamaica recommends that in any consideration of a reformed governance system, a more tailored approach be applied taking into account the peculiarities, perspectives and concerns of MICs.

4. **Resisting the urge towards protectionism.** The tendency towards the introduction of protectionist measures, particularly by developed countries as they introduce stimulus packages, is one that Jamaica would want addressed. The WTO negotiations should also be fully resumed and should address this important issue, given its inconsistency with free trade. There have been some discussions in the WTO on the financial crisis and a report has been issued for Member States to review by the end of March. Jamaica notes that several countries have voiced their objection to protectionism and we therefore urge others to replicate this stance.

5. **New financial regulations.** While supporting the principles espoused by the G20, which underpins the work of the 4 working groups established in the G20 for reform of the financial markets, the G20 proposal for enhancing sound regulation should be carefully considered. Even as the Caribbean region contemplates a regional framework for financial oversight, care should be given to ensuring that any globally considered regulatory framework in the region does not assume a "one size fits all" approach. Account should be taken of the peculiarities of Caribbean countries, even as note is taken that the existing regulatory provisions are shaped by EU financial legislation, which has been influenced by US investment banking institutions, some of which have collapsed. In this regard, we would want to ensure that regulations designed to serve the interests of discredited financial institutions should not be relied on to serve the region's interest.

- Note that the genesis of the crisis is well-known. At the same time, we should avoid the tendency to cast blame. The more immediate concern is to examine how to get out of the crisis. Against this background and the expectation of new strengthened and tougher banking and financial regulations, there is need to resist the urge to shut down off-shore banking sectors in the Caribbean. Offshore institutions are not the cause of the crisis. The region's own draft regional regulations are now on the CARICOM agenda and should be taken into account, given our own peculiarities. It is important that the larger more established off-shore banks be monitored in the same manner.
- Thank you Mr. Chairman.

Intervention of Amb. Claude Heller,
Permanent Representantive of Mexico,
On behalf of the Rio Group

Interactive Thematic Dialogue
On the Financial and Economic Crisis and its Impact on Development
25 March 2008

From the perspective of the members of the Rio Group, we are facing a severe crisis of unprecedented depth, whose scope, duration and consequences are not yet fully measurable nor predictable.

In our opinion, the crisis stems from long-standing structural imbalances in the economies of developed countries, and particularly in the world's largest economy, where its epicenter undoubtedly lies, showing the deficiencies of the international economic and financial system, as well as the urgent need of its reform. The crisis also shows the relevance of the role of the State, as well as the importance of a more appropriate and effective market regulation.

The countries of the region, as a result of the sustained growth achieved over the past six years, and their responsible management of fiscal accounts, are better prepared to face the current crisis than in the past. However, the situation involves important risks and challenges related to a series of phenomena, such as the declining demand in international markets, which affects our ability to export and erodes the terms of trade, the volatility of commodity prices that implies serious challenges for liquidity and capacity planning of producing countries, the shortage of liquidity that is likely to affect both foreign and domestic investment, the decline in the flows of remittances and the deterioration of the situation of migrant workers, as well as the volatility of exchange rates and stock markets, to name some of them.

The crisis has a social impact that must be assessed and addressed immediately in order to maintain the progress achieved in recent years, especially regarding poverty eradication and social inclusion, particularly of the most vulnerable groups. In this regard, we emphasize the need to sustain and strengthen policies and investment in social matters.

The Rio Group countries are convinced of the importance of trade and investment as engines of development. In this regard, we note with concern the impact that could have for our countries the resurgence of protectionism as a reaction to the current global crisis. We also stress the need of a successful conclusion of the Doha Round, which must take into account the interests of developing countries, and the elimination of trade-distorting practices, especially in the agricultural sector.

The countries of the Group have taken concrete actions at national level to provide incentives for trade diversification, including South-South trade, as well as to sustain production and employment, including decent work, in order to mitigate the impact of the current crisis.

In this context, it is necessary to pay special attention and support to the efforts made by Middle-Income Countries, in order to consolidate and make irreversible the progress made by them so far, in terms of development. In the same line, it is essential to consider the development needs of low-income countries and least developed countries.

We reiterate that in order to achieve the internationally agreed development goals, including the Millennium Development Goals, in these times of adversity, it is even more important that donor countries fulfill their commitments regarding Official Development Aid. Likewise, the Members of the Group will keep on working in strengthening South-South Cooperation schemes, and with the participation of traditional donors, those regarding triangular cooperation.

During the last months the topic of the economic and financial crisis has been the center of attention of a significant number of international meetings and initiatives, diverse both in nature and outreach. This includes an important number of meetings and dialogues in our region, where the objectives of cooperation and integration amongst Latin American and Caribbean countries have been reinforced.

We, as Members of the Group, have been reiterating consistently the need for a wide international dialogue with a view to reform the economic and financial international system, with a close and adequate supervision of the functioning and regulation of the financial systems both at the national and the international levels. We reaffirm that it is indispensable to guarantee the full participation of developing countries and emerging economies in the reform of the international economic and financial architecture, one which is favorable to economic and social development.

It is further indispensable to advance towards a profound democratization of the International Financial institutions, with a view to guarantee that, among other elements, the development dimension is at the center of their action. In this regard, it is essential to increase rapidly and decidedly the participation and representation of Developing countries in those institutions, aiming at the Nations of the South to be fully represented in the international decision making process on economic and financial matters.

It is important to recall the central role that must be played by the UN, and particularly by the General Assembly, in this process of reform. This would be useful, among other things, to guarantee the coordination and coherence among the different efforts undertaken, as well as their legitimacy and representation, based upon its universal and democratic nature, as well as in its wide experience and authority in the topics pertaining to the reform, and equally, in the promotion of development from an integral perspective.

The Members of the Group consider the realization of the Conference as a priority. It is an opportunity for our Heads of State and Government, as much as highest level representatives to express their opinion on the topics pertaining to the crisis, including the analysis of its causes and the actions needed to diminish its impact, especially for developing countries. Equally, on the manner to avoid future crisis and foster the necessary reforms to the international economic and financial system, including the Bretton-Woods institutions. This will be a privileged opportunity for our countries to advance in determining coordinated actions in order to face the historical challenges presented by the current situation.

In this frame, we express our appreciation for the Report of the Commission of Experts of the President of the General Assembly, chaired by Professor Joseph Stiglitz, which includes representatives of all the regions. Our respective Governments are in the process of analyzing the report in detail, but we can convey that the results of the Commission of Experts arouse the highest interest for the analysis of the crisis and the definition of future coordinated actions, particularly in the context of the United Nations Conference on World Economic and Financial Crisis and Its Impact on Development.

STATEMENT BY AMBASSADOR BUKUN ONEMOLA, DEPUTY PERMANENT REPRESENTATIVE OF NIGERIA AT THE INTERACTIVE THEMATIC DEBATE ON THE GLOBAL FIANCIAL AND ECONOMIC CRISIS, 25-27 MARCH 2009

Mr. President,

My delegation commends the President of the General Assembly and the Secretary-General for their untiring efforts in championing an all-inclusive response to the global financial crisis, which this thematic interactive dialogue is an integral part of. The panelists have undoubtedly offered useful insight into this very topical issue. We equally appreciate the initiative of the President of the General Assembly in instituting a Commission of Experts on the reform of the International Monetary and Financial System. The incisive assessment of the situation and the recommendations provided by the commission indeed offer a useful road map to solution in the short, medium and long terms. We therefore owe the Commission a wealth of gratitude.

Mr. President,

Nothing has amply demonstrated how interdependent we are than the effects of this global financial crisis which began as a domestic financial crisis in one country and rapidly spread to engulf other countries. Therefore, the current financial crisis has not only exposed how vulnerable national economies can be in an integrated global system but has also paradoxically reenacted the vicious circle of the weak and the vulnerable being more adversely affected by a crisis which they had no hand in igniting. Indeed its snowball effects have compromised the modest growth that the economies of the developing countries have recorded in recent years as well as depleting their capacity to achieve the MDGs and address the challenges of climate change.

Mr. President,

Nigeria, like many other countries, is adversely affected by this crisis, which has threatened to erode the appreciable high economic growth witnessed in the recent years. The impact of the crisis on the Nigerian economy has manifested in declining exports, volatile international oil prices, reduced capital inflows, reduction in the availability of trade finance, local currency depreciation, decrease in remittances from Nigerians in the Diaspora, capital flight resulting in a downward trend in the stock market and enormous losses to stock holders. The financial crisis has also resulted in sharp decline in Nigeria's foreign reserve holding.

In response to this crisis, Nigerian government is giving priority to critical infrastructure that would aid the development of the private sector, thereby increasing income-generating opportunities so as to reduce unemployment and poverty. Furthermore, the Government viewed the crisis as an opportunity to take decisive measures to diversify the economy, tap new opportunities and provide new economic drivers to ensure a more solid and sustainable development.

Mr. President,

In proffering solution to this global crisis, exclusiveness and creeping protectionism should be avoided. In this respect, the collateral victims of this crisis, the least developed and low income countries, must be taken into account and fully involved in any emerging global financial architecture. We also strongly feel that this crisis has given an opportunity to comprehensively reform the Brettonwoods Institutions to be in tune with the realities of the 21st Century world. In fact many of the recommendations of the Commission of Experts, if implemented will go a long way in fashioning the new global architecture we envisaged.

In conclusion, we can not but to agree more with the Commission when it asserts thus: 'as the world focuses on the exigencies of the moment, the long standing commitments to the achievement of the MDGs and protecting the world against the climate change must remain the overarching priorities'. 'Developed countries must make a renewed effort to meet the commitments made in the Millennium Declaration, the Monterrey Consensus, the 2005 Global Summit, and the Doha Declaration by 2015'.

<u>Unofficial translation</u>

<u>Check against delivery</u>

REMARKS

by H.E. Mr. Andrey I. DENISOV

First Deputy Foreign Minister of the Russian Federation at the Interactive Thematic Dialogue of the UN General Assembly on the Financial and Economic Crisis and its Impact on Development

(New York, 25 March 2009)

We're grateful to the President of the UN General Assembly for organizing this interactive thematic dialogue on the world financial and economic crisis and its impact on development. In fact, these days we see that substantive preparations for the UN High-Level Conference to be held in June enter their main phase. Our meeting is of particular importance also in the context of the G20 Summit to take place in London next week. Its decisions should take into account interests of all countries and regions, especially of the most vulnerable ones. The discussion of the UN General Assembly presents a unique opportunity to lay the foundation for future intergovernmental decisions aimed at building new, more effective and equitable system of international economic relations.

Mr. President,

Since last autumn leading experts of national governments and major international organizations have tried to identify the roots of the crisis, forecast its further development and assess its impact. Various anti-crisis policies are being offered, including at the global level. Unfortunately, thus far there are still much more questions than answers.

In our view, the crisis has a system-wide and multi-factor nature.

It was caused, first of all, by the failure of the existing financial system due to underestimated risks and ineffective regulation. The world financial institutions have not adequately responded to developments in recent years. They appeared to have no instruments to prevent and minimize the consequences of crises and no tools to leverage over the strategies of market players. Thus, the world faced serious economic shocks and a threat of global social instability.

Secondly, there are huge imbalances in the world economy. In the context of global economic growth, the generated welfare has been distributed rather unevenly both within States, even highly-developed ones, and among various countries and regions of the world. Decent housing, education and high-quality healthcare are still unaffordable for a major part of humanity.

Moreover, this crisis is a logical outcome of excessive expectations, and not just in business community. Pushing upwards stock indexes and capitalization have become more important than increased productivity and real efficiency of companies' activities.

Thus, what shall be done to restore the normal functioning of the world economy? We believe that the priority is to establish a stable and predictable international economic system based on the well-known rules and the principle of maintenance of macroeconomic and financial discipline by the leading world economies.

Obviously, the current situation requires new collective solutions agreed at the international level.

We have specific proposals to restructure the global financial and economic architecture.

As a matter of priority, we should:

- increase legitimacy and efficiency of international regulatory institutions on a new conventional basis;

- develop an effective risk management system;

- provide continuous monitoring of the situation and strengthen regulation (supernational and national) and supervision over financial sector;

- establish a system of incentives to make market actors behave reasonably based on a balanced risk assessment;

Now I don't have enough time to dwell upon every aspect of our initiatives. Russia's proposals have been made public more than once, including by our senior leaders, and we have been discussing them with all interested partners. We are ready for a dialogue and are willing to consider various ideas in a constructive spirit.

In this regard, I would like to underscore the work of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System headed by the esteemed professor Joseph Stiglitz. We have carefully studied the recommendations of his Commission and found them a generally sound basis for further discussion.

At the same time we think that our experts have much to do yet. It would be useful for the Commission to elaborate a "road map" for the implementation of its recommendations. Moreover, the Commission's experts could provide an expertise to the United Nations follow-up activities after the High-Level Conference to be held in June 2009.

Mr. President,

The current range of the most urgent issues faced by the world economy requires global solutions which can only be adopted on a legitimate basis. It is, first and foremost, the United Nations which has the universal and unchallenged legitimacy.

Therefore, we attach paramount importance to the Conference to be held in June. We consider it as a landmark event aimed at building a sound political foundation with a view to consolidating the efforts by the international community to combat the global crisis. We want it to be successful and we are ready for a constructive dialogue on the whole range of issues related to the Forum.

Obviously, it is impossible to solve all the remaining problems in two months before the Conference, in particular to agree on the details of the new world financial architecture. That is why we suggest a special international conference at the level of authorized representatives, involving experts in relevant fields, which could elaborate specific proposals and draft international conventional arrangements which would provide the basis for a new international monetary and financial architecture.

We are aware that this is not a matter of a few days and, certainly, such decisions should be supported by all States. The main objective is to ensure that concerted international efforts are taken both within the United Nations and other formats, primarily within the G20.

Mr. President,

In the context of the world financial and economic crisis the key task of the United Nations and, in particular, of the High-Level Conference to be held in June is to promote, in every way possible, international development agenda and the achievement of the Millennium Development Goals by all States.

It is important that, through joint efforts, we avert a crisis in the development assistance. This time we should prevent the situation that took place in the early 1990s, when the recession in the world economy was followed by a more than 20 percent cut-off in the development assistance. In this regard we should focus on the support for the most vulnerable populations in developing countries and on financing infrastructure projects which make it possible to ensure economic growth and resolve the issue of unemployment.

Despite a global financial and economic crisis, which has affected Russia as well, we reaffirm our commitments to provide assistance to developing countries. Russia's contribution to the Eurasian Economic Community (EurASEC) Fund, for example, will amount to 7.5 billion USD.

Mr. President,

We cannot consolidate our anti-crisis efforts without mutual trust and, first of all, trust between States. A key joint task is to achieve this mutual trust. It is trust and solidarity that will help us to overcome current problems, avoid many shocks and achieve prosperity and welfare in the 21st century.

Thank you.

SWITZERLAND, CHECK AGAINST DELIVERY

Mr. Chair,

I thank Professor Stiglitz for his briefing and I commend the commission for its efficient work and concise report.

I will focus my intervention today on a few preliminary remarks and questions:

1. We welcome that the report addresses requirements of the moment, but that also keeps in mind our long term commitments to achieve the MDGs and to protect the world against climate change.

2. We also welcome the creativity of the many institutional measures proposed. But we would like to caution against creating new bodies without a clear analysis of possible improvements within the existing set-up. New institutions may face similar difficulties as existing ones: they too will be a reflection of present-day power relationships in the international community.

3. We agree that there is a need for ~~[illegible]~~ an inclusive and representative alternative to the G20 and that the proposed global council represents an interesting idea. Nevertheless, in the light of the ongoing (difficult) UN reform, but also in view of the risk of creating redundancies with ECOSOC responsibilities, we suggest further reflection on such an institution.

4. As to financial regulation, the proposed measures of the report go into the right direction. Notably, stronger regulation of core depository institutions with regard to excessively risky activities or tighter regulation of incentive structures, are advisable.

5. A recently published report named "who cares wins", cosponsored by UN Global Compact, International Finance Corporation and Switzerland, promotes the inclusion of CSR and environmental sustainability into investment decision making. Switzerland is much in favour of such an approach. I hope that the final report of the Commission will take into account such concerns.

COMMENTS BY MR. MODEST MERO, MINISTER PLENIPOTENTIARY OF THE PERMANENT MISSION OF THE UNITED REPUBLIC OF TANZANIA AT THE INTERRACTIVE THEMATIC DIALOGUE ON THE FINANCIAL AND ECONOMIC CRISIS AND ITS IMPACT ON DEVELOPMENT ON 26 MARCH 2009, NEW YORK

Madam Chair,

My delegation wishes to thank the Hon. Heidemarie Zeul Minister for Development Cooperation of the Federal Republic of Germany for her comments of support for the developing countries in this time of the crisis, Professor Joseph Stiglitz for his eloquent presentation on financial crisis focusing on commission of expert's recommendations.

I particularly wish to thank Professor Benno Ndulu, the Governor of the Central Bank of Tanzania, for his well thought out analysis of the crisis and its impacts to Africa.

Madam Chair,

As we listened to their recommendations, we were reminded that TOGETHER, we should endeavor to focus the future of international financial architecture that will address current challenges facing the global community. It is fair to say that these challenges need a renewed political will and paradigm shift on how the international community should reposition itself.

Madam Chair,

My delegation strongly believes that this is indeed, the moment to reshape the way we govern our global economy. It is a moment for bold actions to transform our way of financing development, the way we govern markets, the way we trade, manage the ENVIRONMENT AND indeed, the way that the global economy should best work. Ideas that are being generated in this extremely important meeting will be critical in determining and shaping the future we desire – for this generation and those to follow.

We have been highly encouraged by the statement made by Hon. Minister Heidemarie Zeul of the Federal Republic of Germany and subsequent interventions by the Permanent Representatives of the United Kingdom and Japan who have allocated resources for developing countries and particularly the LDCs during this critical time.

My delegation agrees entirely by Her Excellency that the international financial institutions should continue to foster the multilateral cooperation needed to restore and safeguard international monetary and financial stability and should stand ready to quickly make available sufficient resources to help countries in overcoming crises. We also feel that these institutions should also swiftly address the pressing resource needs of developing countries, especially those that are particularly vulnerable to the adverse impacts of climate change, such as the least developed countries, Small Island developing States, and affected countries in Africa.

Finally I wish to thank all delegations who have renewed their commitments to support developing countries in this time of crisis to mitigate possible effect to the vulnerable community.

I thank you Madam Chair,

PERMANENT MISSION OF THAILAND
TO THE UNITED NATIONS
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Statement

by

His Excellency Mr. Don Pramudwinai

Ambassador and Permanent Representative

of Thailand to the United Nations

on behalf of the Association of Southeast Asian Nations (ASEAN)

at the "Interactive thematic dialogue on the world financial and economic crisis and its impact on development"

at the 63rd session of the General Assembly

New York, 25 March 2009

Please check against delivery

1. I have the honour to speak on behalf of the ten Member States of the Association of Southeast Asian Nations (ASEAN): Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

2. ASEAN commends the President of the General Assembly for organizing this very important meeting on a very important topic that affects all of us. ASEAN attaches great important to strengthening international cooperation to address the current financial and economic crisis and alleviate its impact on development. Therefore, ASEAN warmly welcomes an opportunity to participate in today's debate, which we believe is very timely. We also read with interest the preliminary report of the Commission, which is chaired by Professor Joseph Stiglitz. The said report contains recommendations that can be discussed, not only at our meeting today, but also at the upcoming UN conference on the world financial and economic crisis and its impact on development in June.

3. ASEAN believes that the current global economic crisis demands a concerted and coordinated global response. Due to the closely interconnected nature of the world economy, no country is immune to this crisis and no country can weather it alone. We are, after all, in the same boat. What started off as a financial crisis in developed countries has now become a full-blown economic crisis in all corners of the world to the extent that the world may not have seen since the crisis in the 1930s. So far, there have been extensive damages in both financial and real sectors of both developed and developing countries alike. Developing countries, especially countries that are heavily reliant on export and foreign investment for their growth, have been adversely affected. Sharp contraction of demand and trade flows has already generated massive unemployment in these economies. If not urgently addressed, the current financial and economic crisis could have serious social and political implications on countries around the world.

4. ASEAN believes that a strong and concerted regional cooperation is essential to reinforce and complement various policy measures being undertaken at the national level. This is a lesson that we learnt from the financial crisis that affected our region in the late 1990s. Recognizing the seriousness of the current crisis and the need to act decisively and collectively to address it, ASEAN Leaders met at the 14th ASEAN Summit in Thailand between 28 February and 1 March 2009 and issued a Statement on the Global Economic and Financial Crisis. The Statement encapsulates ASEAN's views, assessments and commitments regarding the current crisis. According to this Statement, ASEAN Leaders noted that ASEAN's economic fundamentals remain sound as a result of structural reforms undertaken since the 1990s crisis. However, the deepening global economic downturn, coupled with heightened risk aversion in financial markets, has adversely impacted trade and investment in the region; and thus, posing significant downside risks to regional economic growth with adverse impacts on 570 million people living in the region. ASEAN Leaders stressed the necessity of proactive and decisive policy actions to restore market confidence and ensure continued financial stability to promote sustainable regional economic growth as well as welcoming expansionary marcroeconomic policies undertaken by each ASEAN Member State to stimulate domestic economy of each country. ASEAN Leaders stressed the importance of coordinating policies and taking joint actions at the regional level, and reaffirmed their commitment to push forward the regional economic integration process to maintain its resilience while remaining open to global and regional trade. By deepening integration, ASEAN is determined to ensure the free flow of goods, services and investment, and freer flow of people and capital in Southeast Asia.

5. ASEAN is also strengthening cooperation with East Asian neighbours to ensure that this region is better equipped to collectively overcome the challenges brought about by the current and future crises. ASEAN believes that, only by working together, East Asian countries would be able to make the most use of their collective wisdoms and capability. In this spirit, ASEAN Leaders welcomed the recent agreement by the ASEAN Plus Three Finance Ministers to increase the size of the Chiang Mai Initiative Multilateralization regional swap arrangement from 80 billion dollars to 120 billion dollars, and to develop a more robust and effective surveillance mechanism to support the operation of the mechanism. It is the strong hope of ASEAN that this landmark arrangement in East Asia will be operationalized as expeditiously as possible, and that it could serve as a good example of regional financial cooperation. The upcoming meetings between ASEAN Leaders and regional partners from China, Japan, Republic of Korea, India, Australia and New Zealand, which is scheduled to be held in Thailand in the middle of April, would be a good opportunity for countries across East Asia to further strengthen regional cooperation and enhance coordination at the regional level to tackle the current economic crisis and alleviate its impact on development.

6. ASEAN recognizes the need for a stronger and more coordinated response at the national, regional and global levels. In this regard, ASEAN believes that the meeting of the General Assembly today will provide a critical impetus and guidance to other international meetings which are scheduled to take place in the near future, for example, the G20 Summit in London, the Special High-level Meeting of the ECOSOC with the Bretton Woods Institutions, the World Trade Organization and UNCTAD, and the upcoming UN Conference on the world financial and economic crisis and its impact on development in June. While ASEAN will actively contribute in all these meetings, ASEAN stresses the importance of synergies between all discussions on the financial crisis.

7. Much has been talked about the upcoming G20 Summit in London. ASEAN attaches importance to this London Summit and will participate actively in the meeting to ensure that the voice and concerns of developing countries would be duly reflected and taken into account in this important gathering. ASEAN believes a more coordinated action by developed and developing countries to restore financial stability and ensure the continued functioning of financial markets is critical. ASEAN believes that the time has come to undertake a bold and urgent reform of the international financial system to achieve a more comprehensive, equitable and inclusive system that takes into account interests and voices of emerging and developing economies. At the same time, the existing financial and regulatory framework also needs to be strengthened. ASEAN will continue to stand firm against protectionism and will intensify efforts to ensure a strong Doha Development Agenda outcome.

8. Last but not least, ASEAN would like to strongly emphasize that, while great attention should be given to fix the current global financial and economic crisis and restore market confidence, the international community should not lose sight of the equally important issues of sustainable development, climate change, food and energy security, and the attainment of the internationally agreed development goals, including the Millennium Development Goals (MDGs). These are issues that directly affect the lives and livelihoods of people around the world. From our first-hand experience of the 1990s crisis, ASEAN knows well that there is no room for complacency because every financial and economic crisis has a human face. And that is why ASEAN believes that this debate today is very crucial.

URUGUAY

INTERVENCIÓN DEL

Sr. EMBAJADOR JOSE LUIS CANCELA

**REPRESENTANTE PERMANENTE DEL URUGUAY
ANTE LAS NACIONES UNIDAS**

ASAMBLEA GENERAL

« DIALOGO TEMATICO INTERACTIVO SOBRE LA CRISIS FINANCIERA Y ECONOMICA MUNDIAL Y SU IMPACTO EN EL DESARROLLO »

Nueva York, 26 de Marzo de 2009

Misión Permanente del Uruguay ante las Naciones Unidas
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Sr. Presidente,

En primer lugar quisiera manifestar que mi delegación se asocia con el discurso pronunciado por el Grupo de Río en el día de ayer.

Asimismo, quisiéramos agradecer el trabajo de la Comisión de Expertos designada por el Presidente de la Asamblea General, el que consideramos un valioso insumo para el debate sobre las posibles soluciones a la actual crisis económica mundial, así como para la preparación de los trabajos de la Conferencia al más alto nivel sobre la Crisis Económica y Financiera mundial y su impacto en el desarrollo, instancia de diálogo futura a la cual nuestro país otorga especial importancia.

El mundo atraviesa una crisis financiera y económica de dimensiones globales, la cual encuentra su origen en el mundo desarrollado. En los últimos años, muchos países en desarrollo han cuidado los equilibrios macroeconómicos, aplicado políticas económicas sólidas y prudentes, aumentado sus reservas, cumplido con sus compromisos financieros internacionales y controlado la actividad de sus bancos para evitar la asunción de riesgos excesivos

No obstante, los efectos adversos de la presente crisis tendrán un impacto mayor en las economías en desarrollo, las cuales no cuentan con los recursos suficientes para implementar las adecuadas medidas anticíclicas que permitan minimizar dichos efectos adversos.

De acuerdo a las primeras estimaciones que han surgido en el marco de las Naciones Unidas, la economía mundial podría detener su crecimiento en el año 2009, mientras que los volúmenes de comercio decrecerían al menos un 3% en el corriente año.

Tanto la contracción del comercio internacional, como la ausencia de crédito y/o liquidez, afectan directamente a los países en desarrollo cuyos patrones de crecimiento se encuentran directamente vinculados al sector exportador y dependen, en gran medida, de los flujos de capital y financiamiento internacional. Asimismo, la inestabilidad en los tipos de cambio impactará negativamente en la capacidad de compra, así como en los términos de intercambio de las economías en desarrollo.

Señor Presidente,

Es imperioso que tomemos acciones concretas para superar la actual crisis económica y financiera. Es necesario que todos seamos participes en la discusión y el diseño de dichas medidas, a efectos de asegurar una adecuada respuesta a los desafíos globales que ésta nos plantea.

Es la hora de la política, de sentarnos a discutir sobre los medios más idóneos para lograr estabilidad y previsibilidad en la economía mundial y concretar un orden económico internacional justo y equitativo que permita alcanzar los Objetivos del Milenio y resolver los problemas del desarrollo.

Señor Presidente,

La crisis hace renacer algunos de los fantasmas más temibles que hemos conocido. Sin duda el proteccionismo está entre los peores enemigos del desarrollo y del bienestar de todas las naciones. Por ello, se vuelve imprescindible: la pronta conclusión de la Ronda Doha, la corrección de las distorsiones que presenta el sistema multilateral de comercio, así como la rebaja de los aranceles, la eliminación de los subsidios a las exportaciones y las restricciones no arancelarias, así como la disminución significativa de las medidas de ayuda interna por parte de los países desarrollados, en particular en el sector agrícola.

Todos estos elementos redundarán no sólo en mercados abiertos y no proteccionistas, sino en un sistema multilateral de comercio mas justo, equilibrado y eficiente, capaz de dar respuesta a los desafíos que plantea la actual crisis económica y financiera global.

Sr. Presidente,

Según los últimos datos publicados por la CEPAL, América Latina crecerá sólo un 1,9 por ciento durante el 2009, frente al 4,6 que alcanzó en 2008. Nuestra región, conformada por una mayoría de países de Renta Media, ha visto caer de manera importante su participación en el Producto Bruto Mundial.

Resulta necesario que las medidas que adoptemos para hacer frente a la crisis, tomen en cuenta los esfuerzos realizados por los Países de Renta Media, en especial en materia de desarrollo, y consideren sus particularidades y necesidades, de forma de tornar irreversibles los progresos alcanzados por éstos.

En ese sentido quisiéramos hacer un llamado a incrementar los esfuerzos en materia de Ayuda Oficial al Desarrollo para poder alcanzar el compromiso del 0.7 % del PBI a la brevedad posible.

Señor Presidente,

Uruguay confía plenamente en el diálogo y en los esfuerzos de la Comunidad Internacional para encontrar soluciones comunes capaces de dar una respuesta adecuada a los desafíos que nos plantea la actual crisis global.

Señor Presidente,

Cuente con nuestro firme compromiso para trabajar constructivamente en pro de su consecución.

Muchas gracias.

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

The Global Economic Crisis: Systemic Failures and Multilateral Remedies

Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation

Executive summary

UNITED NATIONS

New York and Geneva, 2009

Note

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Key messages

UNCTAD's longstanding call for stronger international monetary and financial governance rings true in today's crisis, which is global and systemic in nature. The crisis dynamics reflect failures in national and international financial deregulation, persistent global imbalances, absence of an international monetary system and deep inconsistencies among global trading, financial and monetary policies.

National and multilateral remedies

- **Market fundamentalist *laissez-faire* of the last 20 years has dramatically failed the test. Financial deregulation created the build-up of huge risky positions whose unwinding has pushed the global economy into a debt deflation that can only be countered by government debt inflation:**
  - *The most important task is to break the spiral of falling asset prices and falling demand and to revive the financial sector's ability to provide credit for productive investment, to stimulate economic growth and to avoid deflation of prices. The key objective of regulatory reform has to be the systematic weeding out of financial sophistication with no social return.*

- **Blind faith in the efficiency of deregulated financial markets and the absence of a cooperative financial and monetary system created an illusion of risk-free profits and licensed profligacy through speculative finance in many areas:**
  - *This systemic failure can only be remedied through comprehensive reform and re-regulation with a vigorous role by Governments working in unison. Contrary to traditional views, Governments are well positioned to judge price movements in those markets that are driven by financial speculation and should not hesitate to intervene whenever major disequilibria loom.*

- **The growing role and weight of large-scale financial investors on commodities futures markets have affected commodity prices and their volatility. Speculative bubbles have emerged for some commodities during the boom and have burst after the sub-prime shock:**
  - *Regulators need access to more comprehensive trading data in order to be able to understand what is moving prices and intervene if certain trades look problematic, while key loopholes in regulation need to be closed to ensure that positions on currently unregulated over-the-counter markets do not lead to "excessive speculation".*

- **The absence of a cooperative international system to manage exchange rate fluctuations has facilitated rampant currency speculation and increased the global imbalances. As in Asia 10 years ago, currency speculation and currency crisis has brought a number of countries to the verge of default and dramatically fuelled the crisis:**
  - *Developing countries should not be subject to a "crisis rating" by the same financial markets which have created their trouble. Multilateral or even global exchange rate arrangements are urgently needed to maintain global stability, to avoid the collapse of the international trading system and to pre-empt pro-cyclical policies by crisis-stricken countries.*

Global economic decision-making

- **The crisis has made it all too clear that globalization of trade and finance calls for global cooperation and global regulation. But resolving this crisis and avoiding its recurrence has implications beyond the realm of banking and financial regulation, going to the heart of the question of how to revive and extend multilateralism in a globalizing world.**
- **The United Nations must play a central role in guiding this reform process. It is the only institution which has the universality of membership and credibility to ensure the legitimacy and viability of a reformed governance system. It has proven capacity to provide impartial analysis and pragmatic policy recommendations in this area.**

Foreword by the Secretary-General of UNCTAD

The global deleveraging that first hit the world economy in mid-2007 and that accelerated in autumn 2008 could not have been possible without the rare coincidence of a number of market failures and triggers, some reflecting fundamental imbalances in the global economy and others specific to the functioning of sophisticated financial markets. Chief among these "systemic" factors were the full-fledged deregulation of financial markets and the increased sophistication of speculation techniques and financial engineering. Other determinants were also at play, particularly the systemic incoherence among the international trading, financial and monetary systems, not to mention the failure to reform the global financial architecture. Most recently, the emergence of new and powerful economic actors, especially from the developing countries, without the accompanying reform needed in the framework governing the world economy, accentuated that incoherence.

For many years, even when the global economic outlook was much more positive than today, UNCTAD stressed the need for systemic coherence. It has regularly highlighted the shortcomings of the international economic system and has defied mainstream economic theory in its justification of financial liberalization without a clear global regulatory framework. UNCTAD has drawn attention to the fact that the world economy was overshadowed by serious trade imbalances and has questioned how they could be corrected without disrupting development. We have warned that, in the absence of international macroeconomic policy coordination, the correction could take the form of a hard landing and sharp recession. In recent years, we noted the growing risk that the real economy could become hostage to the whims and volatility of financial markets. Against this background, UNCTAD has always argued in favour of stronger international monetary and financial governance.

A better understanding is required of how lack of proper financial regulation set the scene for increasingly risky speculative operations in commodities and currency markets and of how across-the-board financial deregulation and liberalization have contributed to global imbalances. In doing so, a clearer vision may emerge of how these and other systemic shortcomings can only be remedied by vigorous reform of the international monetary and financial systems through broad-based multilateral cooperative processes and mechanisms that strengthen the role of developing countries in global governance.

Against this backdrop, I established in October 2008 an UNCTAD interdivisional Task Force on Systemic Issues and Economic Cooperation, chaired by the Director of the Division on Globalization and Development Strategies. This group of UNCTAD economists was tasked with examining the systemic dimensions of the crisis and with formulating proposals for policy action nationally and multilaterally. Needless to say, the development dimension and the appropriate responses are at the forefront of UNCTAD's concerns and the issues addressed in this report were identified with that in mind.

There can be no doubt that, apart from the need to strengthen financial regulation at the national level, the current problems of the global economy require global solutions. The United Nations must play a central role in this reform process, not only because it is the only institution which has the universality of membership and credibility to ensure the legitimacy and viability of a reformed governance system, but also because it has proven capacity to provide impartial analysis and pragmatic policy recommendations in this area.

S. Panitchpakdi

Supachai Panitchpakdi
Secretary-General of UNCTAD

Executive summary

The global economic crisis has yet to bottom out. The major industrial economies are in a deep recession, and growth in the developing world is slowing dramatically. The danger of falling into a deflationary trap cannot be dismissed for many important economies. Firefighting remains the order of the day, but it is equally urgent to recognize the root causes for the crisis and to embark on a profound reform of the global economic governance system.

To be sure, the drivers of this crisis are more complex than some simplistic explanations pointing to alleged government failure suggest. Neither "too much liquidity" as the result of "expansionary monetary policy in the United States", nor a "global savings glut" serves to explain the quasi-breakdown of the financial system. Nor does individual misbehaviour. No doubt, without greed of too many agents trying to squeeze double-digit returns out of an economic system that grows only in the lower single-digit range, the crisis would not have erupted with such force. But good policies should have anticipated that human beings can be greedy and short-sighted. The sudden unwinding of speculative positions in practically all segments of the financial market was triggered by the bursting of the United States housing price bubble, but all these bubbles were unsustainable and had to burst sooner or later. For policymakers who should have known better to now assert that greed ran amok or that regulators were "asleep at the wheel" is simply not credible.

Financial deregulation driven by an ideological belief in the virtues of the market has allowed "innovation" of financial instruments that are completely detached from productive activities in the real sector of the economy. Such instruments favour speculative activities that build on apparently convincing information, which in reality is nothing other than an extrapolation of trends into the future. This way, speculation on excessively high returns can support itself – for a while. Many agents disposing of large amounts of (frequently borrowed) money bet on the same "plausible" outcome (such as steadily rising prices of real estate, oil, stocks or currencies). As expectations are confirmed by the media, so-called analysts and policymakers, betting on ever rising prices appears rather risk-free, not reckless.

Contrary to the mainstream view in the theoretical literature in economics, speculation of this kind is not stabilizing; on the contrary, it destabilizes prices. As the "true" price cannot possibly be known in a world characterized by objective uncertainty, the key condition for stabilizing speculation is not fulfilled. Uniform, but wrong, expectations about long-term price trends must sooner or later hit the wall of reality, because funds have not been invested in the productive capacity of the real economy, where they could have generated increases in real income. When the enthusiasm of financial markets meets the reality of the – relatively slow-growing – real economy, an adjustment of exaggerated expectations of actors in financial markets becomes inevitable.

In this situation, the performance of the real economy is largely determined by the amount of outstanding debt: the more economic agents have been directly involved in speculative activities leveraged with borrowed funds, the greater the pain of deleveraging, i.e. the process of adjusting the level of borrowing to diminished revenues. As debtors try to improve their financial situation by selling assets and cutting expenditures, they drive asset prices further down, cutting deeply into profits of companies and forcing new "debt-deflation" elsewhere. This can lead to deflation of prices of goods and services as it constrains the ability to consume and to invest in the economy as a whole. Thus, *the attempts of some actors to service their debts make it more difficult for others to service their debts*. The only way out is government intervention to stabilize the system by "government debt inflation".

* * *

It is instructive to recall the end of the Bretton Woods system, under which the world had enjoyed two decades of prosperity and monetary stability. Since then, the frequency and size of imbalances and of financial crises in the world economy have dramatically increased, culminating in the present one. Since current-account imbalances are mirrored by capital account imbalances, they serve to spread quickly the financial crisis across countries. Countries with a current-account surplus have to credit the difference between their export revenue and their import expenditure to deficit countries, in one form or another. The dramatic increase of debtor–creditor relations between countries also has to do with the way in which developing economies emerging from financial crises since the mid-1990s tried to shelter against the cold winds of global capital markets.

Financial losses in the deficit countries or the inability to repay borrowed funds then directly feed back to the surplus countries and imperil their financial system. This channel of contagion has particularly great potency in today's world, with its glaring lack of governance of international monetary and financial relations. Another important reason for growing imbalances is movements of relative prices in traded goods as a result of speculation in currency and financial markets, which leads to considerable misalignments of exchange rates. Speculation in currency markets due to interest rate differentials has led to overspending in the capital-receiving countries that is now unwinding. With inward capital flows searching for high yield, the currencies of capital-receiving countries (with higher inflation and interest rates) appreciated in nominal and in real terms, leading to large movements in the absolute advantages or the level of overall competitiveness of countries vis-à-vis other countries.

The growing disconnection of the movements of nominal exchange rates with the "fundamentals" (mainly the inflation differential between countries) has been a main cause of the growing global imbalances. For rising economic welfare to be sustainable, it has to be shared without altering the relative competitive positions of countries. Companies gaining market shares at the expense of other companies are an essential ingredient of the market system. But if nations gain at the expense of other nations because of their superior competitive positions, dilemmas can hardly be avoided. If the "winning" nations are not willing to allow a full rebalancing of competitive positions over the long run, they force the "loser" nations into default. This is a phenomenon that J. M. Keynes some 80 years ago called the "transfer problem"; its logic is still valid.

In addition to all these factors, overshooting of commodity prices led to the emergence of – partly very large – current-account surpluses in commodity-exporting countries over the past five years. When the "correction" came, however, the situation of many commodity producers in the poorer and smaller developing countries rapidly deteriorated. There is growing evidence that financialization of commodities futures markets played an important role in the scale and degree of market volatility. Prices in many physical markets for commodities can be driven up by the mere fact that everybody expects higher prices, an expectation that may itself be the result of futures prices that are driven up by shifts of speculative power between financial markets, commodity futures and currency markets.

* * *

The global financial crisis arose amidst the failure of the international community to give the globalized economy credible global rules, especially with regard to international financial relations and macroeconomic policies. The speculative bubbles, starting with the United States housing price bubble, were made possible by an active policy of deregulating financial markets on a global scale, widely endorsed by Governments around the world. The spreading of risk and the severing of risk – and the information about it – were promoted by the use of "securitization" through instruments such as residential mortgages-backed securities that seemed to satisfy investors' hunger for double-digit profits. It is only at this point that greed and profligacy enter the stage. In the presence of more appropriate regulation, expectations on returns of purely financial instruments in the double-digit range would not have been possible.

With real economic growth in most developed countries at under 5 per cent, such expectations are misguided from the beginning. It may be human nature to suppress frustrations of the past, but experts, credit rating agencies, regulators and policy advisors know that everybody cannot gain above average and that the capacity of the real economy to cope with incomes earned from exaggerated real estate and commodity prices or misaligned exchange rates is strictly limited. The experience with the stock market booms of the "new economy" should have delivered that lesson, but instead a large number of financial market actors began to invest their funds in hedge funds and "innovative financial instruments". These funds needed to ever increase their risk exposure for the sake of higher yields, with more sophisticated computer models searching for the best bets, which actually added to the opaqueness of many instruments.

It is only now, through the experience of the crisis, that the relevance of real economic growth and its necessary link to the possible return on capital is slowly coming to be understood by many actors and policymakers.

The crisis has made it all too clear that globalization of trade and finance calls for global cooperation and global regulation. But resolving this crisis and avoiding similar events in the future has implications beyond the realm of banking and financial regulation, going to the heart of the question of how to revive and extend multilateralism in a globalizing world.

* * *

In financial markets, the similarity of the behaviour of many financial market participants and the limited amount of information that guides their behaviour justify considerably greater government intervention. Contrary to atomistic goods and services markets and the colossal quantity of independent data that help form prices, most of the information that determines the behaviour of speculators and hedgers is publicly accessible and the interpretation of these data follows some rather simple explanatory patterns. Neither market participants nor Governments can know equilibrium prices in financial markets. But this is not a valid argument against intervention, as we have learnt now that financial market participants not only have no idea about the equilibrium, but their behaviour tends to drive financial prices systematically away from equilibrium. Governments do not know the equilibrium either, but at some point they are the best positioned to judge when the market is in disequilibrium, especially if functional/social efficiency is to be the overriding criterion of regulation.

If the failure of financial markets has shattered the naïve belief that unfettered financial liberalization and deliberate non-intervention of Governments will maximize welfare, the crisis offers an opportunity to be seized. Governments, supervisory bodies and international institutions have a vital role, allowing society at large to reap the potential benefits of a market system with decentralized decision-making. To ensure that atomistic markets for goods and for services can function efficiently, consistent and forceful intervention in financial markets is necessary by institutions with knowledge about systemic risk that requires quite a different perspective than the assessment of an individual investor's risk. Market fundamentalist *laissez-faire* of the last 20 years has dramatically failed the test. A new start in financial market regulation needs to recognize inescapable lessons from the crisis, such as:

- Financial efficiency should be defined as the sector's ability to stimulate long-term economic growth and provide consumption smoothing services. A key objective of regulatory reform is to devise a system that allows weeding out financial instruments which do not contribute to functional, or social, efficiency;
- Regulatory arbitrage can only be avoided if regulators are able to cover the whole financial system and ensure oversight of all financial transactions on the basis of the risk they produce;
- Micro-prudential regulation must be complemented with macro-prudential policies aimed at building up cushions during good times to avoid draining liquidity during periods of crisis;
- In the absence of a truly cooperative international financial system, developing countries can increase their resilience to external shocks by maintaining a competitive exchange rate and limiting currency and maturity mismatches in both private and public balance sheets. If everything else fails, back-up policies, such as market-friendly capital controls, can limit risk accumulation in good times;
- Developing countries regulators should develop their financial sectors gradually in order to avoid the boom-and-bust cycle;
- Regulators based in different countries should share information, aim at setting similar standards and avoid races to the bottom in financial regulation.

As for the growing presence of financial investors on commodity futures exchanges, several immediate areas are suggested for improved regulation and global cooperation:

- Comprehensive trading data reporting is needed in order to monitor information about sizeable transactions in look-alike contracts that could impact regulated markets, so that regulators can understand what is moving prices and intervene if certain trades look problematic;

- Effective regulatory reform should also close the swap dealer loophole to enable regulators to counter unwarranted impacts from over-the-counter markets on commodity exchanges. Therefore, regulators should be enabled to intervene when swap dealer positions exceed speculative position limits and may represent "excessive speculation";
- Another key regulatory aspect entails extending the product coverage of detailed position reports of United States-based commodity exchanges and requiring non-United States exchanges that trade look-alike contracts to collect similar data. Stepped-up authority would allow regulators to prevent bubble-creating trading behaviour from having adverse consequences for the functioning of commodity futures trading;
- Renewed efforts are needed to design a global institutional arrangement supported by all concerned nations, consisting of a minimum physical grain reserve (to stabilize markets and to respond to emergency cases and humanitarian crises) as well as an intervention mechanism. Intervention in the futures markets should be envisaged when a competent global institution considers market prices to differ significantly from an estimated dynamic price band based on market fundamentals. The global mechanism should be able to bet against the positions of hedge funds and other big market participants, and would assume the role of "market maker".

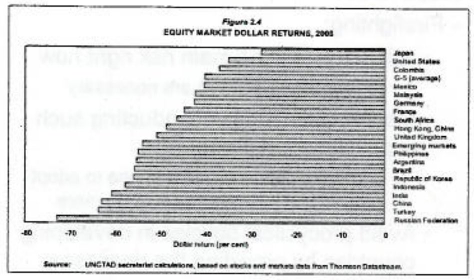
In a globalized economy, interventions in financial markets call for cooperation and coordination of national institutions, and for specialized institutions with a multilateral mandate to oversee national action. In the midst of the crisis, this is even more important than in normal times. The tendency of many Governments to entrust to financial markets again the role of judge or jury in the reform process – and, indeed, over the fate of whole nations – would seem inappropriate. It is indispensable to stabilize exchange rates by direct and coordinated government intervention, supported by multilateral oversight, instead of letting the market find the bottom line and trying to "convince" financial market participants of the "credibility of policies" in the depreciating country, which typically involves pro-cyclical policies such as public expenditure cuts or interest rate hikes.

The problems of excessive speculative financial activity have to be tackled in an integrated fashion. For example, dealing only with the national aspects of re-regulation to prevent a recurrence of housing bubbles and the creation of related risky financial instruments assets would only intensify speculation in other areas such as stock markets. Preventing currency speculation through a new global monetary system with automatically adjusted exchange rates might redirect the speculation searching for quick gains towards commodities futures markets and increase volatility there. The same is true for regional success in fighting speculation, which might put other regions in the spotlight of speculators. Nothing short of closing down the big casino will provide a lasting solution.

THE GLOBAL ECONOMIC CRISIS: SYSTEMIC FAILURES AND MULTILATERAL REMEDIES

Report by the UNCTAD Secretariat Task Force on Systemic Issues and Economic Cooperation

The Myth of Decoupling



A Crisis Foretold

Proximate cause:
- We built too many houses

What really went wrong:
- Inexistent global monetary system
- Weak regulatory regime
  - Global imbalances fed many bubbles

Fighting the last crisis?
- Bad idea if each crisis is different from the previous
- But are they different?
- Avoid regulatory cycles
  - Learn from "near misses"

- Uncertainty associated with the subprime crisis generated a sudden unwinding of speculative position in many markets
- The Report highlights three specific areas in which global markets experienced systemic failure:
  - Financial markets
  - Commodities markets
  - Currency markets

Responses:

- Firefighting:
  - Inflation is *not* the main risk right now
    - Expansionary policies are necessary
  - More coordination in conducting such expansionary policies
    - Countries that have more space to adopt expansionary policies should do more
  - Avoid procyclical policies in developing countries by providing the necessary financial resources

Responses:

- Long term issues (but to be tackled now):
  - Rethink financial regulation
    - Both domestic and international
  - Build a coherent monetary system aimed at avoiding competitive depreciations
    - Multilateral code of conduct
      » Avoid excessive exchange rate volatility
      » Target PPP
  - Build a system for the stabilization of commodity prices

7 Lessons for Financial Regulators

1 Focus on the Right Definition of Financial Efficiency

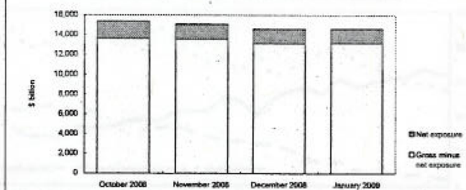
- Five possible definitions (Tobin, 1984)
  - Information arbitrage efficiency
  - Fundamental valuation efficiency
  - Full insurance efficiency
  - Transactional efficiency
  - Functional or social efficiency
    - From the point of view of a regulator, social efficiency should be the only relevant definition of efficiency
    - Several financial products can yield large private returns but have no social return
- Key objective of regulatory reform:
  - Do not stunt financial innovation but weed out financial instruments which increase risk but have no social return

Large Private Returns, But Where Are the Social Returns?

- In 1983, the US financial sector generated 5 per cent of the nation's GDP and accounted for 7.5 per cent of total corporate profits.
- In 2007, the US financial sector generated 8 percent of GDP and accounted for 40 per cent of total corporate profits.
- In the meantime, the US financial sector had to be bailed out 3 times in three decades
  - Tobin (1984) "There must be something wrong with an incentive structure which leads the brightest and most talented graduates to engage in financial activities remote from the production of goods and services"
  - Rodrik (2008) "What are some of the ways in which financial innovation has made our lives measurably and unambiguously better"

Pure Gambling

Figure 2.3
OUTSTANDING CREDIT DEFAULT SWAPS, GROSS AND NET NOTIONAL AMOUNT



Source: UNCTAD secretariat calculations, based on data from the Depository Trust and Clearing Corporation.

2 Market-Based Regulation Does Not Always Work

- There are flaws with the assumption that markets know best and regulators should not try to second guess them
  - Regulation is necessary because markets sometimes do not work.
  - How can one avoid market failures by using the same evaluation instruments used by market participants?
  - Market-based risk indicators (such as high-yield spreads or implicit volatility) tend to be low at the peak of the credit cycle, exactly when risk is high

3 Guaranteeing the Safety of Individual Banks Is Not Enough

- This is a fallacy of composition because actions that are good and prudent for individual institutions may have negative systemic implications
  - Problems with mark-to-market accounting
  - Problem with ratings
- *Macroprudential* regulation needs to complement microprudential regulation
  - It can work like a system of automatic stabilizers which is also good for political economy reasons

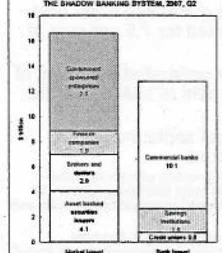
4 Avoid Regulatory Arbitrage

Figure 2.1
LEVERAGE OF TOP-10 UNITED STATES FINANCIAL FIRMS BY SECTOR

Source: UNCTAD secretariat calculations, based on balance sheet data from Thomson Datastream.
Note: Leverage ratio measured as share of shareholders equity over total assets. Data refer to 4 quarter moving average.

4 Avoid Regulatory Arbitrage

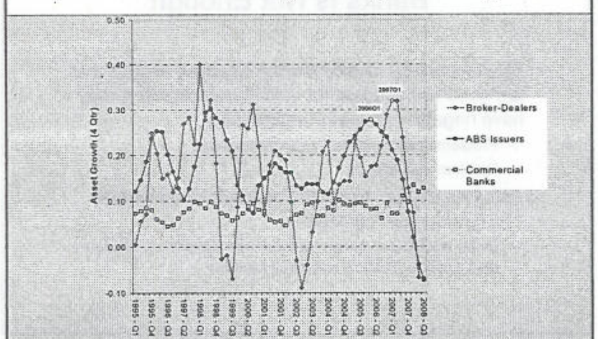
Figure 2.2
THE SHADOW BANKING SYSTEM, 2007, Q2



Source: Shin (2008)

- ➢Each institution can be a source of systemic risk
- ➢Providers of financial products should be supervised on the basis of the risk they produce
  - ➢If an investment banks issues insurance contracts like CDS, it should be supervised like an insurance company
  - ➢If an insurance company is involved into maturity transformation, it should be regulated like bank

4 Avoid Regulatory Arbitrage



5 International Cooperation

- Data sharing
  - No data on cross-border exposure among banks and derivative products
  - Need to develop a system for evaluating cross-border systemic risk
- Need to agree on regulatory responsibility for banks and other financial institutions with an international presence
- Avoid races to the bottom
  - But no common regulatory system
  - Increase the participation of developing countries in standard-setting bodies and agencies in charge of guaranteeing international financial stability

6 Adjust Incentives in The Financial Industry

- Pay structure
- Credit rating agencies

7 Lessons for Developing Countries

- Protect yourself
  - Avoid appreciations
  - Accumulate reserves
    - But they are never enough
  - Avoid currency and maturity mismatches
  - Remember that *it may be* true that a fully open capital account can deliver the goods with a well-regulated financial system
    - But who has a well-regulated financial system?

7 Lessons for Developing Countries

- Developing countries are often characterized by a non-competitive financial system in which banks make good profits by paying low interest on deposits and charging high interest rates on loans, which they only extend to super-safe borrowers
- Financial development is good
  - But it can also increase vulnerabilities because it alters the incentives structure of the various players within the financial system (Rajan, 2005)
  - Developing country regulators should develop their financial sectors gradually to avoid boom and bust cycles

7 Lessons for Developing Countries

- There is no one-size fits all financial regulatory system
  - We now realize that good financial regulation is very difficult to implement.
  - Thus, there may be a trade off between financial sophistication and stability
    - Countries with more ability to regulate and that are better prepared to absorb shocks may want to adopt a more aggressive process of liberalization
    - Other countries may want to be more cautious
    - The right approach is the one of Deng Xiaoping

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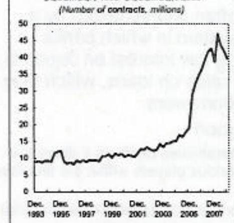
Commodities

Financialization of Commodity Futures Trading

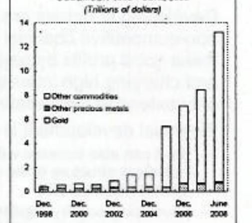
- The build-up and eruption of crisis in the financial system was paralleled by an unusually sharp increase and subsequent strong reversal of the prices of internationally traded primary commodities
- The strong and sustained increase in primary commodity prices between 2002 and mid-2008 was accompanied by a growing presence of financial investors on commodity futures exchanges ("financialization" of commodity markets)

Figure 3.2
FUTURES AND OPTIONS CONTRACTS OUTSTANDING ON COMMODITY EXCHANGES, DECEMBER 1993–DECEMBER 2008
(Number of contracts, millions)



Source: BIS, *Quarterly Review*, March 2009, table 23B.

Figure 3.3
NOTIONAL AMOUNT OF OUTSTANDING OVER-THE-COUNTER COMMODITY DERIVATIVES, DECEMBER 1998 – JUNE 2008
(Trillions of dollars)



Source: BIS, *Quarterly Review*, December 2008, table 19

Financialization of Commodity Futures Trading

- Regulators need access to more comprehensive trading data in order to be able to understand what drives prices and, if necessary, intervene
- Key loopholes in regulation need to be closed to ensure that swap dealer positions do not lead to 'excessive speculation'

Exchange Rates

Exchange Rate Regimes and Monetary Cooperation

- Speculation through carry trade pushes exchange rates in the "wrong" direction
  - The case for reform of the current global non-system draws from the distorting influence that the present monetary chaos exerts on the effectiveness of international trade
  - The new system should be based on just one exchange rate/price adjustment rule: nominal exchange rate changes should follow the difference in the price levels of the trading partners
  - This can ensure a level playing field through stable real exchange rate
- How to do it?
  - System of planets and satellites

THE GLOBAL ECONOMIC CRISIS: SYSTEMIC FAILURES AND MULTILATERAL REMEDIES

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The crisis: Origins, evolution, systemic aspects and what to do

Interactive Thematic Dialogue

On the Financial and Economic Crisis and Its Impact on Development

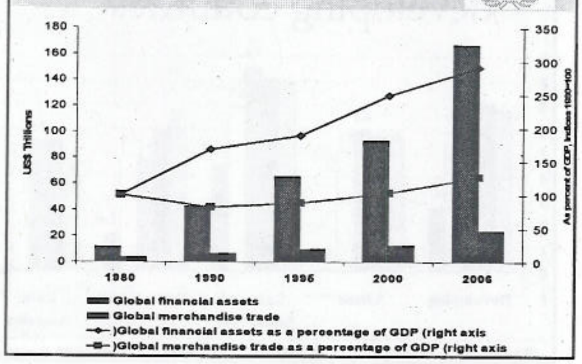
United Nations Headquarters, New York

25 March 2009

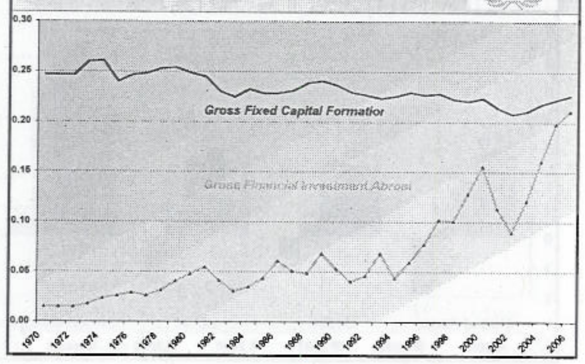
Crisis No One Expected?

- *A crisis foretold*
- *Unsustainable global imbalances*
- International financial *architecture*
- *Ideology*: deregulation, self-regulation, K account liberalization
- *Financial Globalization*: growth, stability?
- Most developing countries *innocent victims*
- *Policy responses*: inadequate; double standards
- *International cooperation*: G7, G20, UN

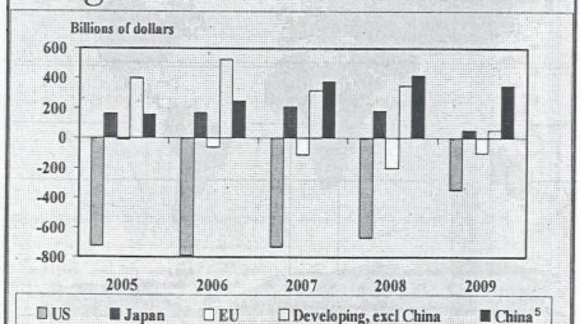
Globalization finance-driven



Finance-investment nexus?



Disorderly unwinding of global imbalances



Crisis unfolds

Financial vector:

Sub-prime crisis → financial crisis

→asset price deflation → credit crunch

Financial crisis → Real economy recession

Real economy vector (including vicious circles):

→Less investment

→Less consumption

→Reduced demand for imports, i.e. for exports of others

→Prices, output decline

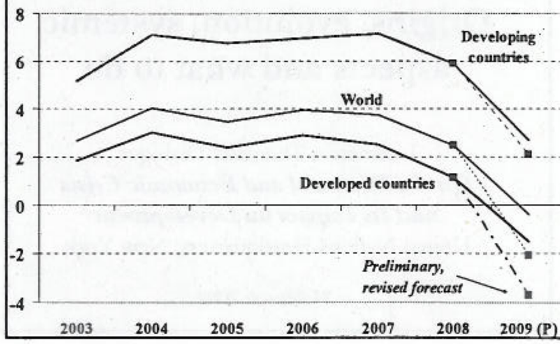
→Growth, employment decline

6

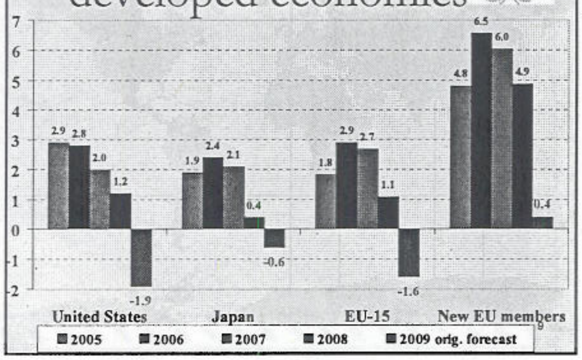
Deflationary spiral

- Asset (stock, property) markets deflating
  → negative wealth effect
  → more bank insolvency
  → generalized credit squeeze
- Lower external demand, world trade
  → excess capacity
  → investment slowdown
- Lower employment, incomes
  → depressed domestic demand

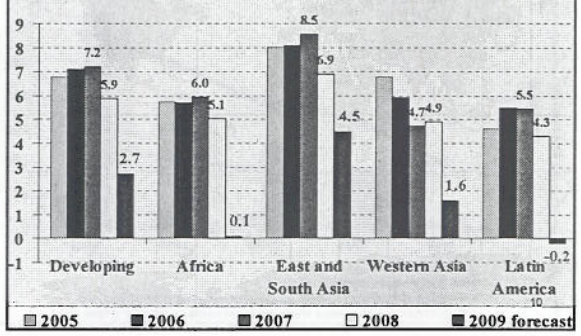
Globalization: Parallel fates



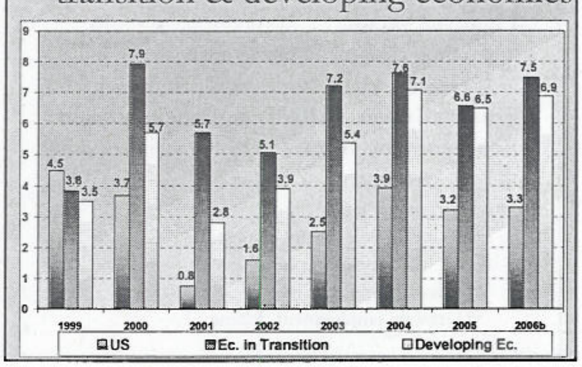
Recession in most developed economies



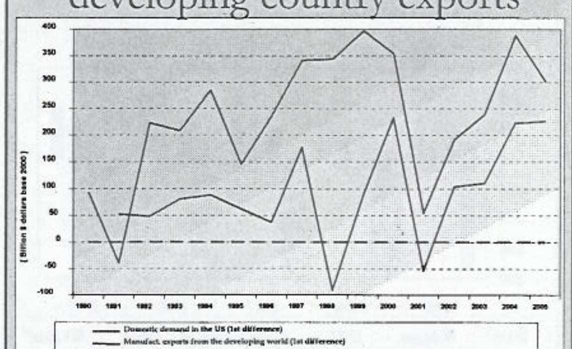
Slowing growth in all developing countries



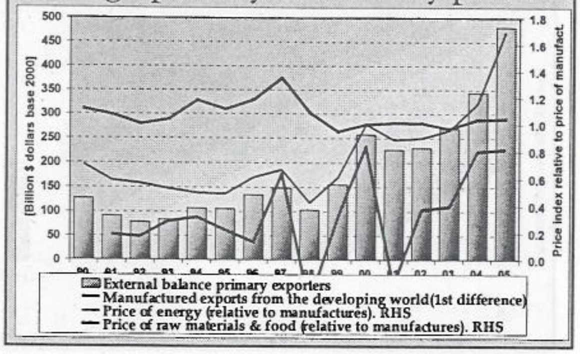
Synchronous growth: The US, transition & developing economies



Strong US demand lifted developing country exports



Manufacturing demand supported high primary commodity prices



High commodity prices over

- Last 5 years: rare opportunity for many developing countries – including LDCs – to generate substantial financial resources from higher primary commodity exports for investments and growth – *largely over*
- 2008 price spikes for energy and food due to speculation following flight from 'Wall Street' (finance) to 'Chicago' (commodity futures), other factors

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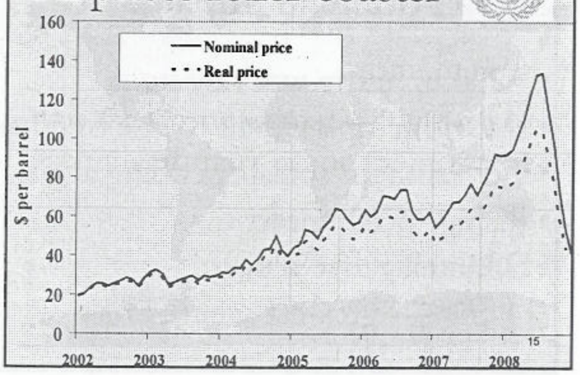
Oil prices roller-coaster



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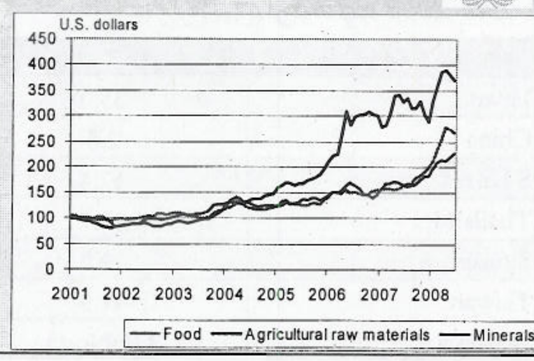
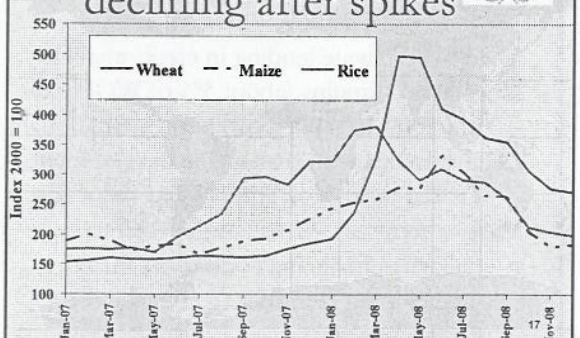
Non-oil commodity prices



World food prices declining after spikes



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Financial impacts on developing countries

- Despite non-involvement in sub-prime debacle:
  - → Emerging *stock markets* collapse greater
  - → Reversal of *capital flows*, FDI down
  - → Spreads rise, much higher *borrowing costs*
- But *financial positions stronger* than during Asian + LA crises (more foreign reserves, better fiscal balances)

Though reserves rapidly evaporating with export collapse

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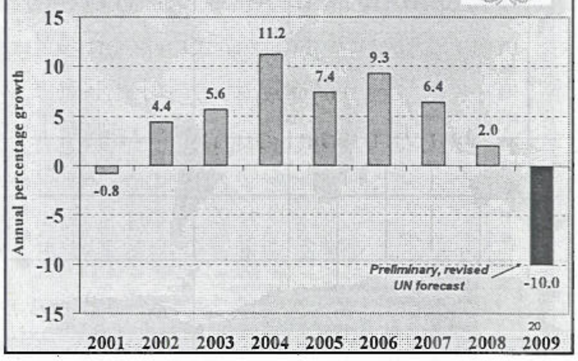
Trade impacts

- Exports decline →
  all developing countries
- Terms of trade → **primary exporters**
- **Trade surpluses,**
  reserves may run down quickly
- **Lower energy, food prices →**
  net food and oil-importers

World trade collapsing



Export Implosion in E. Asia

Dec. 2008 exports y-o-y (%)

	%
Japan	-35.0
China	-2.8
S Korea	-17.4
Thailand	-15.7
Singapore	-20.0
Taiwan	-41.9
Malaysia	-4.9 (Nov.)

Social, political impacts

- >200 m. more working poor
- ILO: Unemployment to rise by 51m
- Government social spending at risk
- Rising social unrest
- US intelligence report:
  crisis -- greatest security risk

Rising to the challenges?

Extraordinary responses to crisis
- $11 trillion committed public funds so far (~ 20% of WGP)
- Credit crunch
- Coordinated monetary responses have not worked due to liquidity trap
- Fiscal stimulus packages (~ $2 trillion so far, or 3% of WGP), but:
  - Mostly by developed countries
  - Still too small
  - Not globally coordinated

Bolder action needed

More and bolder action needed:
- Need to reactivate lending in credit markets
- More fiscal stimulus (about 3% of WGP/year in 2009-10) and coordinate internationally
- Align stimulus with sustainable development, social protection and poverty reduction
- Massive transfers ($1 trillion) needed to alleviate financing constraints for developing countries to enhance their policy space

Large transfers needed

- Enormous asymmetry in capacity to respond
- A few developing countries have large reserves, most do not
- Collapsing trade → depletion of reserves
- Need for massive transfers to developing countries ($1 trillion over next 2 years):
  - $500bn int'l liquidity: SDRs, reserve pooling
  - $500bn for devt financing and ODA for fiscal stimuli with devt objectives

Risks

- Fiscal stimulus ineffective, if financial system continues to fail to respond
- Monetary effects of stimulus could cause further asset deflation and destabilize exchange rates if fiscal stimulus fails
- Increased social and political unrest

→ Need well-coordinated solutions

→ Need medium-term framework

→ Need to monitor distributive effects

Systemic flaws

- Establish credible and effective mechanism for international policy coordination and reform BWIs' governance
- Reform existing systems of financial regulation and supervision
- Reform liquidity provisioning
- Reform international reserve system

Policy priorities

- ***Limit spread of financial crisis***
  - Across borders (contagion)
  - To real economy (ensuring liquidity)
- ***Reflate economy***
  - Fiscal measures (fiscal space needed)
  - Monetary measures (monetary space)
- ***Appropriate regulatory reform***
  - National
  - International

Regulatory priorities

- *Prudential risk management,* including *capital controls*
- *Counter-cyclical*: limit pro-cyclicality
- Finance growth (output, *employment*)
- *Development* finance, e.g. crucial for investment + technology policies
- *Inclusive* finance

Domestic demand

- Need to stimulate to *offset* weakened foreign demand for X-oriented
- Most countries' fiscal space limited

  → need more *policy space* to cope
- *Domestic* -- not external -- financing
- Build + improve physical *infrastructure*
- Strengthen *social services*, protection

Social protection counter-cyclical

- *Employment* crucial,
  especially for poverty reduction
- Fiscal stimulus, esp. for *job creation*
- Conditional cash/income *transfers*
- *Universal* vs targeted social protection
- Social protection → demand maintenance

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Constraints on developing country responses

- IMF requirement for fiscal stimulus
- IMF claim developing countries likely to fail
- Policy -- including fiscal -- space constrained
- Monetary policy less effective, worse with independent central banks, fiscal authority
- Systemic, market pro-cyclicality
- Lost productive capacities due to openness

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New Bretton Woods moment?

Bretton Woods: United Nations conference on monetary and financial affairs

- 15 years after 1929 Depression
- Middle of WW2
- US initiative vs UK Treasury stance
- 44 countries (28 developing countries; 19 LA)
- IMF, IBRD, ITO – UN system
- Clear emphasis on sustaining growth, employment creation, development,
  not just financial stability
- But BWIs very different governance arrangements

Responses to crisis

- UN, BIS forecasts more accurate than others; IMF, WB upbeat till late 2008
- IMF, WB also marginalized by G7, etc
- IMF discouraging strong fiscal stimulus by developing countries without surplus
- G7 → G20: inclusive? legitimate? crisis-, but not development- or equity-focused
- PGA (Stiglitz) Commission of Experts
- Doha Declaration: June 09 summit on impact of crisis on developing countries

UN role?

- *Lead* reform process?
- Ensure *comprehensive systemic* reform
- Ensure *developmental* financial system
- Ensure *inclusive* financial system
- Develop capacity for offering *2nd opinion* to interested member states
- Align IMF, WB with UNDA, IADGs to ensure *policy coherence*

Thank you

Please visit UN-DESA www.un.org , *G24* www.g24.org and *PGA* www.un.org/ga/president/63/ *websites*

- Research papers
- Policy briefs
- Other documents

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Statement by the South Centre

Statement at the UN General Assembly Extraordinary Thematic Dialogue on The World Financial And Economic Crisis And Its Impact On Development made by **Martin Khor, Executive Director, South Centre,** New York, 25 March 2009

1. The extraordinarily serious global economic crisis has its origins in the developed countries. Developing countries are not responsible, but they are severely affected, and in ways that are worse than the developed countries, as they also lack the means to counter the effects.

2. Developing countries are only in the past few months beginning to feel the effects of the crisis, due to the lag time in transmission. The crisis is expected to last at least a few years, and then it may take more time before a full recovery.

3. There is thus growing anxiety in the developing world. When he met the British Prime Minister Mr. Gordon Brown, last week, as part of the preparation for the G20 Summit, the Ethiopian Prime Minister Mr. Meles Zenawi warned that African countries could face political chaos if the recession hits at full force. In developed countries such as Britain, the worst problem being faced in the downturn was unemployment. But in Africa, the recession means that "people who were getting some food would cease to get it and instead of beng unemployed they would die", said Mr. Zenawi, as quoted in the Financial Times.

4. The developing countries are being hit at four levels The **first is through the trade transmission route.** There has been a sudden and steep fall in manufacturing exports, the fall being 30 to 50% in many Asian countries. Then there is the fall in demand, prices and export earnings for commodities, affecting especially low-income commodity-dependent countries. On 17 March, The Economist's commodity-price dollar index for all items had fallen by 40% compared to a year ago (with declines of 29% for food, 44% for non-food agriculture products and 56% for metals). Earnings from services are also falling, for example in tourism (in the Caribbean tourist arrivals are expected to fall by one third this season) and migrant workers' remittances (a 6% drop is estimated by the World Bank for 2009)..

5. The **second transmission channel is through finance.** There is a rapid decline of bank loans to developing countries, whose companies may find it difficult to roll the many hundreds of billions of dollars of foreign loans due this year. There is a reversal of portfolio investment into developing countries, from large inflows in recent years to a

sudden huge exit. Net capital flows to emerging markets fell from $929 billion in 2007 to $466 billion in 2008 and will fall further to $165 billion in 2009, according to the estimates by Institute of International Finance. There is a potential decline in aid and FDI. Trade financing has also been affected by risk aversion, and is choking trade flows; a shortfall of $25 billion in trade financing was reported at a recent WTO meeting. .

6. **Thirdly,** these trade and finance problems are leading to stresses on the overall balance of payments, with a fall in foreign reserves, and a depreciation of the local currency in some countries. All these together threaten developing countries' ability to service their external debt and avoid a debt default situation. There are already 10 countries that have had to go to the IMF for emergency loans and many other countries may be lining up in the near future.

7. **Fourthly**, all of the above are causing a stress on the real economy, with declines in GNP and industrial output, a reversal in poverty eradication and a slowdown in social development, as governments face reduced revenues and budgetary stress. Most developing countries are constrained from taking the fiscal expansion measures similar to those of developed countries.

8. There is a need for developing countries to examine the options for national policy on each aspect of the economic crisis and to seek the appropriate policies. However, only some policy measures can be taken at national level, especially if the country is too small to rely on the boosting of domestic-led growth. Regional-level measures are important. And most critical are the reforms, actions and cooperative measures required at the international level.

9. The South Centre views the two issues of reform of the international architecture and international actions needed to counter the recession from the **perspective of the problems and interests of the developing countries**. What are the priority issues for the developing countries, on which action is urgently required?

10. Among the **priorities for the South** are (1) establishing an international system that fosters financial stability for developing countries; (2) having access to enough financial resources, as financial flows and exports decline; (3) avoidance of financial and debt crises and proper management of crises if they occur; (4) access to markets for goods and services; (5) avoiding collateral damage from policies taken by developed countries to deal with their problems; (6) formulating policies for the short and long term for recovery and development, and being able to maintain and expand policy space to implement these policies.

11. There is need to review and reform the international financial and economic systems to ensure the problems that led to the crisis are not repeated and that the international

system does not prevent but positively encourages developing countries to have the adequate policy space to deal with the crisis nationally.

12. There are dangers that some **crisis measures taken by developed countries may have adverse effects on the South,** and thus a need to prevent or offset these actions. For example, developed countries' agriculture subsidies used to be the main distortion in world trade but these are now accompanied by huge subsidies to financial institutions and emerging subsidies to manufacturing (the auto industry). Developing countries lack funds to match these subsidies; they should be allowed to take measures to prevent subsidised service providers like banks and subsidised goods from overwhelming their domestic markets. In the area of tariffs, developing countries should be allowed to exercise their right to use the policy space to raise their applied tariff if it is below the bound tariff. A moratorium against raising applied tariffs would be imbalanced because there is little difference between the applied and bound rates in developed countries, unlike the developing countries.

13. Private investors and public agencies in some developing countries invested in or lent to private and public institutions in developed countries. Developed countries' governments should **assure that the assets of developing countries are protected.** Pressures from interest groups that exclude developing countries' assets or loans from bailout plans (for example the suggestion that AIG should only honour claims from nationally-owned institutions) should be resisted.

14. **New forms of trade protection** that affect developing countries should not be introduced.

(a) The fiscal stimulus programmes should not exclude goods and services from developing countries, as has happened with the Buy American clause in the recent US stimulus package. Developed countries are mainly exempted from the clause due to their membership of the WTO plurilateral procurement agreement, of which most developing countries are not members.

(b) When developed countries introduce national plans or legislation to deal with climate change, these should not incorporate a trade protection element, such as "border adjustment measures" to be taken on products based on the amount of carbon dioxide emitted during the production of goods. This would impose an additional tax or a payment of "emission allowances" on exports of developing countries, many of which may thus be blocked from developed countries' markets. Developing countries' products tend to have more pollution intensity due to the lack of financial resources and modern technology, and the lack of implementation of developed-country commitments to transfer these to the developing countries under various conventions and agreements. There is need for equitable solutions to the global efforts to deal with climate change, without resort to unilateral actions that unfairly affect developing countries and cast a shadow over the trade and the climate regimes.

15. A high priority for developing countries is to **establish international measures to foster financial stability and avoid activities driven by speculation.** The crisis originated in the financial sector in developed countries, while an important transmission mechanism spreading the crisis to developing countries is through the deregulation of capital flows (unrelated to trade and investment) and the floating of exchange rates, causing speculation to be rife in capital and currency markets. Developing countries have been hit by these speculative activities, the violent fluctuations in capital flows and the financial instability (for example, in the Asian crisis, and the present crisis). An important part of the solution is to reinstall firewalls and regulations to avoid speculative capital flows unrelated to real economic activities (trade and investment) and to establish a system of currency exchange where currency rates reflect basic values. This should be a major priority in the reform of the international financial architecture.

16. In the absence of reform and an international system regulating these flows, developing countries must have the policy space and be allowed to undertake **national policy measures to regulate capital flows** and to defend themselves from speculation. However the required policy space to take the required measures is hindered by (1) IMF-World Bank conditionality that mandates an open capital account; (2) Many North-South free trade agreements that (a) mandate the free and unregulated inflow and outflow of funds; (b) liberalisation of financial services, including the entry of foreign institutions for "new financial instruments"; (c) liberalisation and deregulation of investments. These barriers (the loan conditionality and the FTA provisions) to the required regulation should be reviewed. Existing FTAs should be reviewed to consider amending clauses that prevent the required regulation. Current negotiations on FTAs such as the EPAs between the EU and the African and Pacific countries should fully take this into account.

17. A major plank of the new financial architecture is the **reform of the IMF.** Its policy conditionalities have previously not been appropriate in assisting developing countries deal with crises. These include: (1) the policy of an open capital account system, that deregulates capital flows (increasing financial vulnerability) and discourages or prevents capital controls over inflows and outflows; (2) pro-cyclical monetary and fiscal policies that have magnified contractionary conditions; (3) trade policy linked to extreme liberalisation of imports and industrial policy based on non-state intervention, which have damaged domestic agriculture and industry in many developing countries. A preliminary review of recent crisis loans to 10 countries (including some developing countries) by the IMF show that contractionary financial and fiscal policies (such as a significant increase in interest rates, and a reduction of government spending) are still maintained as part of the loan conditions.

18. A reform of the IMF is thus crucial. Without the reform, it is premature to expand its resources. The IMF should not impose or promote an open capital account or prevent regulation of capital flows. It should not deal with trade and industrial policies and other development-related policies. The reform process should lead to its creditor role being confined to providing short-term loans to countries to deal with temporary balance of payments difficulties. In that area, its policies should be counter-cyclical and not pro-cyclical. Countries should not be requested to provide loans to the IMF to augment its resources because this would compromise the ability of the IMF to carry out its surveillance function and to discipline the policies of countries that provide the loans. It can obtain resources from the market or from the issuance of SDRs, instead of obtaining loans from governments. The imbalances in the system of governance, with its present serious imbalance in voting rights and decision-making, should also be addressed.[1]

19. One major source of financial instability is that the **international reserve currency** is the currency of a single country (the United States). This causes instability as availability of reserves for the world economy depends on the reserve currency country (the US) having growing current account deficits. This problem is worsened under the present crisis because of : (a) the absence of multilateral discipline over exchange rate and macroeconomic policies of the US; (b) developing countries' increased vulnerability to fluctuations in capital flows and exchange rates; (c) pro-cyclical behaviour of financial markets; (d) developing countries holding large stocks of foreign reserves at very high costs. As an alternative, an international reserves system based on the SDRs could be established. The IMF could distribute SDRs to itself to make it available to members, and there should be greater automaticity in access to it.[2]

20. The new financial architecture should include establishment of **a multilateral fund or funds for the use of developing countries**. This could be similar to the two oil facilities set up in the 1970s to assist countries cope with the oil price increases and to prevent a global recession. The fund can assist developing countries counter the recession and to offset the multiple losses of financing caused by reduced exports, migrant remittances, service payments, loans, investments, trade financing, etc. The shortfall facing developing countries may total many hundreds of billions of dollars a year. The fund should thus be of a major amount. The channels of funding and its multiple uses should be determined together by the international community.

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[1] Several of these points are in Yilmaz Akyuz, "Key issues in the reform of the international financial architecture"; and "The IMF is back in business – as usual?"

[2] The points in this paragraph are from Yilmaz Akyuz, "Key issues in the reform of he international financial architecture."

21. Developing countries should also be encouraged to explore and expand regional financial cooperation. Examples of this are the Chiangmai Initiative and its extension in Asia, and the Bank of the South in Latin America.

22. The new financial architecture should also **deal with the threat of new debt crises facing developing countries**. The current account and overall balance of payments of many developing countries and their foreign reserves are or will be coming under increasing stress, due to a crisis that was not of their doing. The reform process should as a priority establish **an international system of debt standstill and debt workout** for countries that face debt servicing difficulties. Proposals on this (which originated at UNCTAD) had been rather extensively discussed, including at the IMF, but did not lead to any conclusions. Given the present crisis, this should again be a priority proposal. A new round of debt elimination and debt relief should also be looked at now.

23. For many of the poorer countries, dependence on commodities has revived as a serious problem because the positive conditions and high prices of the past several years have vanished. The stabilisation of commodity prices and fair remuneration to producing countries has thus become a priority crisis issue for developing countries. **International cooperation on resolving commodity issues** should thus be on the reform agenda.

24. The crisis provides an opportunity to address the deficits and imbalances in the governance of global finance and economic issues. The United Nations used to play a central role in policy formulation and in reaching and implementing agreements. However in recent years, too much faith and power had been given instead to the markets and to international financial institutions which supported the drive towards "marketisation" and "financialisation." At the national level, in developed countries in the centre of the storm, the pendulum has swung, with the leadership and interventionist role of the state being emphasised. The international counterpart of this national-level development should be the strengthening of the role of the United Nations, including its General Assembly and its economic arms, particularly ECOSOC. Greater authority provided to a **strengthened and more effective UN** should be a crucial element of the new global economic architecture.

25. The UN General Assembly high-level conference in June is an important opportunity for discussion and follow-up actions on the wide range of issues of the crisis and how it affects development, and the remedies required. The South Centre is willing to contribute to the success of this very important event.

COMMISSION OF EXPERTS OF THE PRESIDENT OF THE UN GENERAL ASSEMBLY ON REFORMS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

Submission by the Global Unions[1] – 13 February, 2009

I. Financial Regulation

Broad Principles

Global Unions call for the establishment of a national and international regulatory architecture that would ensure economic, social and environmental sustainability. This regulatory framework should induce a shift away from financial markets' short-termism and the primacy of shareholders' value and ensure that financial markets return to their primary function (i.e. financing of the real economy). The regulatory framework should aim at limiting the negative social and environmental impacts of financial activities and give incentives to achieve full, decent employment and the transition to a low carbon economy.

Specific Principles

1. Global Unions consider the following measures essential for regulating financial markets:

- Ensuring that central banks are publicly accountable for their actions and have the necessary mandate to deter and detect speculative financial bubbles;
- Ensuring active supervision, proper counter-cyclical asset requirements and accounting rules for banks and large financial conglomerates;
- Prohibiting all forms of credit risk-related off-balance sheet transaction;
- Submitting foreign investments and capital flows to proper domestic regulation, including observance of internationally recognised governance and transparency standards;
- Promoting community-based financial services such as cooperative and mutual systems and targeted micro-finance schemes negotiated with national social partners;
- Improving consumer protection so as to protect households against predatory lending and aggressive sales policies by banks;
- Enhancing the social purpose of pension schemes to provide decent retirement in both pension funding and investment regulations;
- Establishing an international regime for taxing financial transactions, the proceeds from which could help support social and development objectives;
- Regulating credit risk transfers, derivatives and futures and addressing the oligopolistic structure of the credit rating agency industry, including by establishing public agencies and developing non-financial sustainability rating;
- Regulating private investment firms such as hedge funds and private equity, and combating regulatory arbitrage within large financial groups and between jurisdictions;

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[1] The Global Unions group is made up of the International Trade Union Confederation (ITUC), which has 170 million members organized in 312 national trade union centres in 157 countries; the Global Union Federations (GUFs), which represent their respective sectors at the international trade union level (BWI, EI, IAEA, ICEM, IFJ, IMF, ITF, ITGLWF, IUF, PSI and UNI); and the Trade Union Advisory Committee (TUAC) to the OECD.

- Adopting controls to limit speculative behaviour in trade exchanges including commodities and energy markets;
- Curbing corporate short-termism by strengthening governance and tax rules on executive compensation, board of directors' responsibilities, risk management and distribution of corporate profits;
- Tackling the loss of tax revenues resulting from the use of tax havens by ensuring that all governments take the necessary steps to protect their revenue base, so as to offset expected substantial reductions in corporate tax receipts resulting from the crisis in the real economy. At multilateral level, this includes strengthening political support for the OECD's work on the transparency of tax havens;
- Ensuring that public information is available on the nature of newly created financial products (in addition to the information provided by public rating agencies);
- Encouraging the inclusion of social and environmental indicators in investment decisions by requesting annual information reports on non-financial issues;
- Promoting the inclusion of the concept of sustainability in the notion of fiduciary responsibility;
- Promoting workers' representation in pensions funds and (financial) companies' boards and ensuring they have a say in investment decisions;
- Limiting leverage by ensuring respect for a minimum capital requirement;
- Creating independent authorities to provide objective information on financial products and contracts so as to reduce asymmetry of information on financial markets;
- Internationally, ensuring that the regulatory framework protects developing countries highly dependent on foreign capital against destabilising short term movements.

Theme 2: Multilateral Issues

Broad Principles

Global Unions believe that now is the time to reshape the global financial and economic architecture through a new set of negotiations that go beyond the exchange rate regime created at Bretton Woods in 1944. By reducing the role of the state and by promoting labour market deregulation in the countries in which they were implemented, IMF policies and programmes contributed significantly to the rise in inequalities worldwide, a major cause of the current crisis. Furthermore the unbalanced governance structures of the IFIs made them unable to carry out their supervisory role successfully and to warn against or prevent the current crisis, and the IFIs do not have the credibility to determine the new financial architecture, which should be designed through a consultative multilateral process including representation of trade union organisations.

Specific Proposals

1. Current arrangements for international financial regulation have been significantly unsatisfactory. There is a need to review existing institutions for financial regulation, economic policy supervision and development finance at the global level, with a view to ensuring transparency, accountability and a clear relationship to the framework provided by the United Nations and its General Assembly.

2. Developing countries need support for their economic and social development and when there are balance of payments difficulties, in which context the case for strengthening the role of regional development banks should be considered. A broader number of currencies need to

be used as a reference point to reduce over-reliance on the dollar, in order to offset the cost of exchange rate fluctuation born by borrowing countries. International institutions should absorb a broader part of the fluctuation risks faced by borrowing developing countries with regard to both interest and exchange rates.

3. Emerging economy and developing country governments must form a central part of the new governance structure of the IFIs so as to prevent any country from having undue power or a veto over the decision making process. In the case of the World Bank, whose mandate is focused on developing countries, there is a need for a deep and systematic reform which must result, at the very least, in parity of voting power between developing and industrialised countries.

4. Liberalisation of capital markets in developing countries should not be promoted by international institutions as the risks of destabilisation for weaker economies are too high. Both the World Bank and the IMF must put an end to the economic policy conditionality that has characterised their interventions in developing countries over the past three decades. This has minimised rather than strengthened the application of fiduciary controls and respect for internationally agreed standards, including core labour standards. The deregulation, liberalisation and privatisation conditionalities of the IFIs, in addition to interfering with countries' own policy choices, have frequently led to serious and damaging impacts.

5. Financial support to countries with balance of payment deficits should protect employment and social safety nets. It should be provided quickly to help boost demand, and stimulate growth.

6. The normative standards of the ILO, and notably core labour standards, must underpin the new governance system. Governments must now encourage and rebuild the institutions that help distribute income and wealth more fairly, as opposed to continuing to call for deregulation of labour markets and dismantlement of workers' protection. The worsening economic situation, on top of the explosion in food prices over the past year, will further accentuate income inequality and add to the deficit of decent work across the developing world, which has already been identified by the ILO.

7. There is a need for a new growth regime that – as was the case during the post-war period until the early 1980s – ensures balanced real wage growth in line with productivity increases. Fair responsible and progressive taxation neither facilitate the accrual of fortunes, nor provide incentives for the pursuit of speculation, but rather contribute to growth. Wage stagnation and the lack of purchasing power for working families are both a result of damaging policies and themselves a major factor behind the fall in household savings and the emergence of unsustainable debt that led to the mortgage crisis in many countries. Financial deregulation allowed creditors to promote borrowing against home equity as a substitute for income. Financial bubbles in asset prices, stimulated by excessive leverage and lax rules, substituted for sustainable growth based on shared earnings.

8. Whilst governments must lead the work, the debate must not be held between bankers and finance ministry officials behind closed doors. Trade unions representing working families across the globe – the victims of the current crisis – must be present at the table.

Theme 3: Macroeconomic issues and addressing the crisis

Broad Principles

1. Recovery packages should be designed to redress the underlying fundamental economic imbalances that have produced the current crises. These are notably the imbalance between the US and other parts of the global economy, the imbalance between finance and the real economy and the imbalance of bargaining power between workers and their employers. Those economies that have surpluses should redirect them to supporting domestic consumption and productive investment. Trade union rights should be fully respected and promoted so that workers can improve their living standards.

2. A new approach to fiscal responsibility must accompany a global New Deal. The worst error in the current circumstances would be to cut public sector budgets further. There must be a renewed commitment to the provision of publicly financed, quality public services.

3. It is essential that recovery measures contribute to efforts to reduce greenhouse gas emissions and to attaining greater carbon efficiency, and do not detract from those multilaterally established objectives, thereby assisting in the obtention of an ambitious agreement at the UN Conference of the Parties in Copenhagen in December 2009.

Specific Proposals

1. Fiscal stabilisers such as unemployment benefit schemes must be strengthened and supplemented by direct job creation schemes, where necessary. Fiscal stimuli should target increases in aggregate demand of sufficient magnitude to revitalise the real economy: employment, wage and household disposable income growth. Tax and expenditure measures must be targeted at low and middle income families who are suffering most in the current situation and who, having higher consumption rates, will feed this back into consumption, production and hence employment most rapidly.

2. While most industrialised countries have adopted various types of counter-cyclical fiscal stimulus programmes, most developing countries are operating pro-cyclically, often through no fault of their own but because they are pressured by the IFIs to practice "fiscal discipline". The international community must be more supportive of recovery programmes implemented by developing countries, which can prevent poverty from growing further and accelerate the global recovery, and this requires increased financial assistance from IFIs and donor countries. At a minimum, industrialised-country governments must fulfil the commitments they made at the G8 Gleneagles Summit to increase the level of ODA.

3. In developing and emerging countries, governments should counter economic slowdown through monetary policy, by supporting job creation programmes and extending or creating social safety nets. Macroeconomic policies are not gender neutral. Attention must be paid to the disproportionate negative impacts of the crisis on women, and measures taken to counter these, in the context of job creation programmes, social safety nets, and the provision of social services. The IFIs must not repeat the errors of the Asian financial crisis a decade ago by pressuring countries to increase interest rates, cutting back government spending and allowing widespread bank failures – the opposite of what industrialised countries are doing today. Instead developing countries should be encouraged to maintain levels of employment and offer government assistance to the most vulnerable sectors of the population.

4. The international community must swiftly expand emergency loans through the IMF and increase assistance from the World Bank and UN agencies to the many developing and emerging countries that are likely to be in situations of balance-of-payments deficits because of the financial crisis and continued high food and fuel prices. There must be no austerity conditions attached to this support. Rather there should be 'positive conditionality', which assists countries to restore short-term growth, fair distribution of costs and benefits and long-term sustainability.

5. Similarly, the World Bank should give priority to projects that are employment-intensive, extend social safety nets to the majority of developing-country workers currently without protection, and build up public services and infrastructure for sustainable growth. Proposals have to be agreed with workers organisations in the countries concerned. Governments must also agree emergency responses to the continuing food crisis, including action to counter speculation in food markets and to extend emergency support to the poorest. In the medium term, steps should be taken to expand sustainable food production and rebuild buffer stocks. Beyond this, governments must, in the coming months, identify the steps to be undertaken to ensure that they meet their commitments on ODA and the MDGs.

6. Rethinking the responsibilities of both the private and public sectors must include responsible resourcing of the public sector through fair taxation and a new commitment to efficiency and the ethical value of quality public services, in which the organisations representing public employees can play a key role.

7. There is an urgent need to maintain and expand social protection, which will require putting in place more progressive tax regimes and expanding social protection systems. It is important to remember that, even as unemployment is predicted to increase sharply in 2009, a majority of the world's workers do not have recourse to unemployment benefits when they lose their jobs and most can rely only on their own savings or their family's support when they reach old age.

8. Restoring the public legitimacy of the world trading system and concluding the Doha Round requires simultaneous progress on the enforcement of the protection of fundamental workers' rights through all international institutions, including the WTO, and on ensuring that developing countries are able to achieve economic recovery, employment and future industrial development.

Theme 4: Reforming the global financial architecture

Broad Principles

1. Global Unions agree that institutional reforms must go beyond financial regulation and introduce sustainable economic management aimed at reducing the imbalances and asymmetries in the global economy, as well as efficient and equitable allocation of resources to the real economy, including for employment, decent work, social protection, and green jobs.

2. Reforming the global financial architecture must be anchored in the right institutional arrangements and principles that support the process in socially sustainable ways. Therefore, reform of the institutions of global governance must go hand in hand with reform of the global financial architecture. Institutional arrangements must be inclusive and operate

democratically, allowing representative groupings of all countries to participate in the process of finding solutions to restore sustainable economic growth with decent livelihoods for all. Consultative mechanisms must be built into these governance arrangements, allowing for the full participation of trade unions and other constituents of civil society.

Specific Proposals

1. Global Unions support an enhanced role for the UN in the establishment of global regulations. There is a need for policy coherence between the IFIs, WTO and UN institutions, in particular as concerns the currently unequal importance given to employment creation (and decent work) by the different institutions.

2. Establishing better accountability and transparency mechanisms in financial and international systems of governance and organisations is essential in order to coordinate efforts in reducing the economic and social vulnerability caused by macroeconomic instability and exacerbated by high food prices and climate change.

3. At multilateral level, maximum use should be made of existing institutional competencies in the financial, economic, trade, environment, development, human rights, social and employment fields. The various multilateral institutions with mandates in these fields must establish strong mechanisms of cooperation and collaboration, ensuring that policy responses reinforce each other, in the interests of sustainable growth and development, and not undermine each other. The process of reforming the institutions of global governance therefore provides an opportunity to revamp policies with negative social impacts that have served to exacerbate the crisis, such as the policy conditionalities of the IFIs, imposed capital accounts liberalisation, privatisation of pension funds and the provision of social services, and the liberalisation of trade in services.

4. The United Nations and its specialised agencies in the social, development, environmental, human rights, employment fields (ECOSOC, DCF, the Human Rights Council, ILO, UNEP, UNDP, UNIFEM) should be central to institutional arrangements for effective global governance to deliver social justice and a fair globalisation. They should form the core of an Economic and Social Security Council that would be a convening authority to bring the key global governance actors together, with a strong coordinating role, linking the economic, financial and trading systems to policies for employment, development, environmental sustainability, gender justice, and poverty eradication.

5. Furthermore, in light of the overlapping nature of the various topics under discussion by this Commission, reference is needed to the Global Unions responses above under Item I, "Financial Regulation" and Item 2, "Multilateral Issues".

Civil Society Consultation on the Work of the President of the UN General Assembly's Commission of Experts on Reforms of the International Monetary and Financial System

NGLS
UN Non-Governmental Liaison Service

A compilation report prepared by the United Nations Non-Governmental Liaison Service (UN-NGLS)

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Background and Methodology

In the wake of the global financial and economic crisis, the President of the United Nations General Assembly set up a Commission of Experts on Reforms of the International Monetary and Financial System to reflect on the causes of the crisis, assess its impacts on all countries and suggest adequate responses to avoid its recurrence and to begin the process of restoring global economic stability. The Commission has a relatively short span of time to carry out its work and to produce a final report, to be distributed to Member States, other involved parties and the wider public, as part of a larger United Nations initiative to achieve the needed financial and economic reforms. The report will be considered in the preparatory process leading up to the UN Conference at the highest level on the world financial and economic crisis and its impact on development (called for in the final document adopted at Doha in December 2008 – resolution A/RES/63/239).

The GA President called upon the UN Non-Governmental Liaison Service (NGLS) to bring together civil society-based expertise and insights and compile it into one report in order to inform the preparations of the President's Commission on Financial Reforms. NGLS accomplished this through a three-week online consultation (26 January-13 February) that sought feedback on the four working themes of the Commission (financial regulation; multilateral issues; macroeconomic issues and addressing the crisis; and reforming the global financial architecture). NGLS then had ten days to prepare this report.

Nearly 100 responses were received during the consultation, many of them from different networks that bring together millions of people on different issues (trade, gender, global unions, environment, etc.) across several countries from the North and the South. Many of the organisations that responded are networks of hundreds of organizations or even "networks of networks" representing thousands of members. Other submissions reflect the views of a smaller number of organizations or people.

The NGLS online consultation aimed at being as inclusive as possible and was designed to interface with the way the Commission is structuring its work. NGLS has an extensive outreach capacity to civil society organizations; and, once informed, the organizations themselves took it upon themselves to advertise the consultation within their own networks.

The NGLS report does not represent a "consensus document" among NGOs, but aims to reflect the content of civil society proposals to reform the international financial and monetary system. It is hoped that it will serve to spark debate and to shed light on a number of issues.

For further information on methodology of this consultation, see the NGLS website (www.un-ngls.org/scf). A number of NGO submissions can also be found there.

Executive Summary

The ongoing financial crisis and its continuing spillover into the global economy has created a crisis of survival for the poor – nations as well as people. Economies have been slowing down, jobs have been lost, capital inflows are drying up, commodity prices and exchange rates are showing signs of increasing volatility, and all these factors are pushing countries to the brink of economic crisis.

It is increasingly becoming clear that the current crisis is deepening and requires a global response. [ActionAid International]

While the responses to the consultation were many and varied, there were several central themes that emerged. First, almost all respondents agreed that the responsibility for the current financial crisis lies in the developed world. It is therefore developed countries that must carry out the most fundamental changes, both in terms of their domestic policies and in the positions they take in international economic governance fora. For most respondents, the current global financial and economic crisis exposed a misguided macroeconomic policy framework that civil society had denounced for decades and was symptomatic of a democratic deficit in global economic governance, including the lack of meaningful voice for developing countries in relevant decision-making fora.

Many argued not only for a stronger role for the United Nations in the immediate response to the crisis: responsibility for coordinating the longer term global economic and financial reforms should ultimately fall squarely with the United Nations, as the most globally representative and participatory body currently in existence. Major reform decisions that will affect all countries cannot be left to the G8 or even the G-20. In the same vein, when calling for in-depth reform of the World Bank, the IMF and the other principal international financial institutions (IFIs), as well as the possible creation of new global regulatory bodies, most respondents advocated that these be brought institutionally under the purview of a strengthened United Nations, and be in practice accountable to UN human rights, development and environmental objectives (Chapter 2).

Immediate Response to the Crisis: A Strategic Opportunity

One way developed countries should take responsibility for the current crisis is first, to maintain their ODA commitments; and, second, prepare a "global financial stimulus package" that would be directed at developing countries. This package should bring no new debt nor should it be attached to conditionalities that would limit developing countries' ability to respond to the crisis in a flexible manner. Indeed, the package should enhance their ability to choose from a range of policy options including capital controls (which should be "re-legitimized" as essential crisis prevention and mitigation tools) and various counter-cyclical measures. This stimulus could also include debt relief from arrears accumulated over the previous decades.

Any kind of stimulus should take the social dimensions of the current crisis into account and gender impacts in particular. Almost all submissions raised the need for introducing some kind of "social floor" in the wake of the current crisis. It was argued that various forms of social protection – often the first victim of budget cuts – should instead be expanded in this time of crisis. Many insisted that these measures would in fact have a positive long-term impact on the development of all countries. The crisis should further be an opportunity to reorient macroeconomic policies (including the mandate of central banks) so as to be made consistent with full and decent employment and development goals (Chapter 3).

Indeed, most respondents urged governments "not to waste" the current crisis but to use it as an opportunity to address the other "crises" (food and climate, jobless growth and below-poverty-line informal work) and to develop long-term sustainable social and economic development strategies. Respondents were adamant that the crisis be used as an opportunity notably to develop a *green global economy that respects and preserves our global common goods, prevents further global warming and ensures a sustainable, safe and clean environment for future generations.* [Social Watch]

International Tax Cooperation

The multiple dimensions of international tax policy were treated by many contributors as a major regulatory issue, as well as a necessary redistributive instrument. Tax loopholes translate in regulatory loopholes, as well as a massive hemorrhage of public revenue and source of global injustice. Resource mobilization through international tax cooperation was seen as all the more necessary in the current context of gargantuan deficit-funded bail outs and stimuli in rich countries and constraints on the ability of poorer countries to pursue counter-cyclical policies and maintain budgetary spending. This included cooperation to curb or eliminate tax havens, tax evasion and transfer pricing, regional cooperation to set floors on corporate taxes, as well as various forms of international taxation (notably a currency transaction tax) that could raise significant resources as well as play a regulatory role. Some called for the creation of an International Tax Organization while significantly strengthening the UN's work on tax cooperation in the interim (Chapter 1).

Re-regulating Finance to Work for People and the Real Economy

A host of concrete proposals were put forward to bring transparency to the financial system and downscale systemic risk, including by shutting down secrecy jurisdictions, raising capital requirements on derivatives and hedge fund markets, placing limits on leverage ratios and effective "socialization" of financial institutions that are "too big to fail." With the dual food and energy price crises that preceded the full global impact of the financial crisis, many contributors stressed the need for special public measures to curb or eliminate speculation on staple-food-related-commodity and energy markets.

Various proposals mentioned the need for "counter-cyclical" regulation as an essential alternative to the pro-cyclical "boom and bust" policies that characterized the self-regulation paradigm embodied in Basel II. Beyond that, participants saw a regulatory role in directing finance to long-term societal goals and bringing it back to one of its core functions of financing production in the real economy. This could be achieved through a combination of prohibitions, penalties and incentives, the screening of capital entries, and new regulations that favour (instead of *de facto* penalizing) cooperative forms of finance and community reinvestment. It also meant a fundamental review of rating agencies and redefining risk criteria to include parameters of long-term sustainability and social cohesion (Chapter 1).

A New Sovereign Debt Architecture

Many international campaigning networks on debt provided a comprehensive approach to construct a new sovereign debt architecture, including a fair and transparent orderly debt workout mechanism and the cancelling of odious and illegitimate debt. Frequent mention was made of what was described as the historic decision taken by Norway to cancel several claims on the basis of "failed development policy" and "co-responsibility." In addition, the comprehensive debt audit conducted by Ecuador and the suspension of payments on some claims subject to further investigation were cited by many contributors as a model the UN should encourage and support.

There was a wide call to review and redefine debt sustainability in terms of human development and human rights goals. It would aim also to deter creditors from engaging in irresponsible lending and could form the basis for developing a common platform or covenant for principled and responsible financing (Chapter 4).

Global Financial Architecture: Redressing Global Imbalances and Asymmetries

Many contributions proposed various measures to address global imbalances and asymmetries in the global economy which contributed to the current and past crises and reinforced global inequities, notably in terms of South-North net financial flows and unequal capabilities in crisis response.

A number of contributions identified sharp gyrations in exchange rates as a major source of instability and inequity, affecting trade relations often more fundamentally than trade determinants on the official trade agenda – calling for the UN to play a leading role in addressing this perennial issue since the collapse of the Bretton Woods system in the 1970s. In particular, some contributions encouraged the Commission to consider UNCTAD's recent proposal for a multilateral exchange regime to stave off currency speculation.

Regional approaches as an alternative or stepping stone to multilateral exchange rate stabilization were indeed emphasized by a number of participants, often described in the context of more comprehensive regional development agendas, including the *Banco del Sur* in Latin America, and regional currency arrangements and reserve pooling. Mention was made notably of the "Ecuadorian proposal," involving intensified regional monetary cooperation towards regional exchange rate mechanisms, the pooling of reserves and their convertibility into a new regional currency.

A few participants contributed and commented on proposals for more fundamental global financial architecture reform involving the creation of a new global reserve system to anchor exchange rates, with "seigniorage" (emission) capacities, and involving symmetrical disciplines on surplus and deficit countries. Proposals ranged from the IMF issuing Special Drawing Rights (SDRs) for financial and currency stabilization as well as development objectives, to the establishment of an

International Money Clearing Unit (IMCU) that only central banks would hold among nations that would abide by the rules of a clearing union system. This system would involve symmetrical responsibilities among surplus and deficit countries.

Others were more circumspect about global monetary solutions. A key question in the possible move to a new system of fixed exchange rates was how the initial rate of each country would be set in the context of power imbalances associated with asymmetric currency values. Until such political obstacles could be surmounted, many preferred regional approaches, and insisted that the first line of defense for developing countries remained the effective use of capital controls (or "capital management" techniques) to manage destabilizing capital movements (including speculative attacks on national currencies), screen the quality of capital entries and prevent capital flight (Chapter 4).

Solutions to the present crises should not be premised on re-establishing or saving a failed system, but on changing it. The UN can and must rise to this occasion. [Jubilee South]

THEME 1: FINANCIAL REGULATION

The financial crisis is a systemic crisis that emerges in the context of global crises (climate, food, energy, social...) and of a new balance of power. It results from 30 years of transfer of income from labour towards capital. This tendency should be reversed. This crisis is the consequence of a capitalist system of production based on laissez-faire and fed by short term accumulation of profits by a minority, unequal redistribution of wealth, an unfair trade system, the perpetration and accumulation of irresponsible, ecological and illegitimate debt, natural resource plunder and the privatization of public services. This crisis affects the whole humanity, first of all the most vulnerable (workers, jobless, farmers, migrants, women...) and Southern countries, which are the victims of a crisis for which they are not at all responsible.

The resources to get out of the crisis merely burden the public with the losses in order to save, with no real public benefit, a financial system that is at the root of the current cataclysm. Where are the resources for the populations which are the victims of the crisis? The world not only needs regulations, but also a new paradigm which puts the financial system at the service of a new international democratic system based on the satisfaction of human rights, decent work, food sovereignty, respect for the environment, cultural diversity, the social and solidarity economy and a new concept of wealth. ["Let's put finance in its place!"; Belem 1 February 2009, NGO Sign-on Statement]

I. CROSS-CUTTING ISSUES

Many of the civil society contributions approached the question of financial regulation by placing emphasis on two cross-cutting issues that are relevant to the other themes of the Commission agenda. These are:

- capital controls (or "capital management techniques") and
- international tax policy (ranging from international taxes on financial transactions to addressing tax evasion, tax havens and offshore banking)

Re-legitimizing capital controls

Capital controls were seen as particularly important to prevent and mitigate the impact of the global financial crisis on developing countries. Their effective use needed to be re-legitimized at both the national and regional levels (including bilateral and regional free trade agreements) and in international policy frameworks.

Alongside other important regulatory instruments, capital controls can be crucial during a financial crisis. Unfortunately, the era of deregulation has made developing countries extremely vulnerable to capital outflows in a time of crisis, compounding their current difficulties. This needs to be addressed by the work of the Commission.
a) Governments should take responsibility for controlling cross-border capital flows, which must be better monitored. In particular, poorer States should not be penalized for doing so, or forced to adopt any particular economic policies.
b) Multilateral, regional and bilateral financial liberalization clauses should be revised. The use of capital controls should be relegitimised by developing countries

and international financial institutions (IFIs) should provide technical assistance on how to introduce them. [Oxfam International]

The international orthodoxy of recent years, that developing countries would obtain great benefits while having little risks in having a financially open system, is now losing credence in light of the extremely high costs being paid by several countries that opened up and experienced the sudden entry and exit of foreign funds, with the resulting instability and economic dislocation. A new paradigm is emerging that grants that developing countries should have and, indeed, should sometimes take the option of maintaining or imposing capital controls to protect their interests and to enable a degree of financial stability. Especially in the absence of international regulation of capital flows, capital controls should not be taboo but be seen as a normal, acceptable and, indeed, valuable component of the array of policy options available to promote development.

This emerging paradigm is one of the outcomes of the East Asian financial crisis made even more pertinent by the current crisis. In order for developing countries to be able to exercise this option, however, the present prejudices against such controls should be removed. [Third World Network]

Capital control measures, such as deposit requirements to discourage short term speculative investors need to be reintroduced as part of the tools available to governments to avoid capital flights and speculative attacks. [Social Watch]

[T]he flexibility of many affected countries to introduce the capital management techniques and regulations required by the crisis has been compromised already by bilateral trade and investment agreements. Indeed, in the last few years, it has become common for such agreements to include provisions that constrain the capacity of governments to manage the financial sector, the capital account and sovereign debt...The global financial crisis is leading to significant losses of jobs, as well as real wage and benefit reductions. The implementation of pro-employment fiscal, monetary and banking policies, such as exchange rate-targeting, is also compromised by the disciplines on capital management and respective dispute settlement clauses contained in agreements on trade and investment. [International Working Group on Trade-Finance Linkages- Steering Committee]

To stem speculative activities, governmental authorities should avail from a menu of capital management techniques available to regulate the volatility of capital flows. [Women's Working Group on Financing for Development]

Establish international permanent and binding mechanisms of control over capital flows. ["Let's put finance in its place!"; Belem 1 February 2009, 'Sign-on' Statement]

It was noted that capital management techniques are not only needed for crisis prevention and mitigation, but also to support longer-term macroeconomic and development goals discussed under Theme 3, as was common practice in the early post-World War II era.

Control on capital flows are imposed for two reasons: firstly, as part of macroeconomic management (to reinforce or substitute for monetary and fiscal *measures) and secondly to attain long-term national development goals (such as ensuring residents' capital is locally invested or that certain types of activities are reserved for residents). Contrary to the belief that capital controls are rare, taboo or practised only by a few countries that are somehow "anti-market," the reality is that these measures have been very widely used. In early post-war years, capital controls for macroeconomic reasons were generally imposed on outflows of funds as part of policies dealing with balance-of-payments difficulties and to avoid or reduce devaluations. Rich and poor countries alike also used controls on capital inflows for longer-term development reasons. When freer capital movements were allowed from the 1960s onwards, large capital inflows posed problems for rich countries such as Germany, Holland and Switzerland. They imposed controls such as limits on non-residents' purchase of local debt securities and on bank deposits of non-residents.* [Third World Network]

International tax policy

The multiple dimensions of international tax policy were treated by many contributors as a major regulatory issue, as well as a necessary redistributive instrument. Tax loopholes translate into regulatory loopholes as well as a massive haemorrhage of public revenue and source of global injustice.

Tax evasion, tax havens and offshore banking

A number of contributions highlighted the harmful role of tax havens and secrecy jurisdictions, notably in causing the global financial crisis.

In a world of global banks and 24 hour financial markets, regulation is only as effective as the weakest link in the chain: tax havens are the weakest link. This explains why so much of the "financial innovation" of the past two decades can be traced back to these places. The majority of hedge funds are located in London, the Cayman Islands and the British Channel Islands. Ditto the private equity industry; the issuance of securitised debt; the re-insurance industry, and the structured investment vehicles at the heart of the shadow banking system. [Tax Justice Network]

Ensuring secrecy, offshore banking centres have also played a crucial role in the current financial turmoil. Not only have these centres enabled complex financial arrangements and allowed the concealment of excessive risks, but they have also contributed to international capital flight. Billions of dollars that could have helped developing countries to mitigate the effects of the current crisis or to finance social development have been transferred to tax havens. Capital flight from poor to rich countries is estimated to range between 500 and 800 billions US$ per year.
[Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

Many contributions focused on the need for the international community to take action to limit or eradicate offshore banking and tax havens.

The fact that tax havens are on the G20 agenda is an opportunity that must be seized by the Commission to make progress on this issue.... Tax havens should be closed so as to significantly reduce illicit capital flight and tax evasion. Transition measures for affected developing countries that host them may be worth considering. [Oxfam International]

Small vulnerable economies that have turned into tax havens, many with citizens who do not take any advantage of the offshore status, need support and financial assistance to diversify their income and comply with standards to prevent money laundering. [CIDSE]

Specific proposals included a UN Code of Conduct on cooperation in combating international tax evasion and avoidance, as well as for the establishment of an International Tax Organization under the auspices of the UN.

Shut down secrecy jurisdictions, the shadow banking system and offshore financial centres (OFC) as a way to eliminate cross-border tax evasion and capital flight and limit the scope for future tax avoidance, in order to mobilise much-needed resources for sustainable development. As first step, strong regulation on bank transfers to OFC need to be developed. Ultimately, an international tax organization under UN auspices is needed for the democratic control of taxation, i.e. to combat tax competition, tax evasion and corrupt capital flight. As a first step, the UN Tax Committee [United Nations Committee of Experts on International Cooperation in Tax Matters] should be upgraded considerably. [Social Watch]

The same array of proposals was echoed by other contributions, including in more specific detail:

Along with the adoption of a UN Code of Conduct on cooperation in combating international tax evasion and avoidance and putting in place an intergovernmental UN organ for International Cooperation on Tax Matters, there should be a renewed black-listing of non-cooperative tax havens, combining the work of the OECD, FATF and FSF. It should include all States and territories, including major financial centres unwilling to agree to the automatic exchange of tax and judicial information, to abandon strict banking secrecy and to register trusts' beneficial owners. Gradual and strong retaliation measures should be taken against uncooperative tax havens. Promotion or undertaking tax evasion should be a criminal offence and made legally actionable, targeting their users: TNCs, banks, rich individuals; and financial intermediaries: corporate directors, lawyers and accountants in large financial centres. US action against UBS evidences the ability of a tax administration to extract information on off-shore accounts despite banking secrecy. Tax evasion should also be included under anti money-laundering legislation. Anti-money laundering efforts should be stepped up and particularly enhanced in developing countries, including by the strengthening of regional Financial Action Task Forces and by providing them with constraining power. [CIDSE]

Governments must systematically reform and regulate offshore banking jurisdictions. Schemes such as the European Union Savings Tax Directive must be tightened up to force automatic exchange of information between all legal entities and should progressively be extended to become a global regulation. Governments should support the intergovernmental work on reform of taxation, by upgrading the UN Committee of Tax Experts to the status of an intergovernmental body, providing sufficient resources to undertake its task, moving quickly to adopt the UN Code of Conduct on combating tax evasion and avoidance and strengthening judicial and tax *cooperation through information exchange, effective black-listing of non-cooperative tax havens and obligations to repatriate stolen assets.* [SOLIDAR]

Comprehensive reforms are needed which will eradicate all of the mechanisms that the financiers, lawyers, accountants and their clients use to take advantage of tax havens. This will include demands for:

- *comprehensive disclosure of ownership data;*
- *the closure of bank subsidiaries located in tax havens;*
- *adoption of a country-by-country reporting standard for multinational companies;*
- *abolition of the use of "off-balance" sheet accounting vehicles;*
- *effective steps to tackle trade mispricing;*
- *taxation of hedge fund profits as income rather than capital gains;*
- *a multilateral tax information exchange treaty based on automatic exchange.*

Taken as a package, these measures will severely restrict the use and abuse of tax havens. Many can be expected to collapse and might need transitional support to restructure their economies. [Tax Justice Network]

Transfer pricing

Closely related to the above, a number of contributors sought to end the practice of transnational corporations manipulating their accounts through distorted transfer pricing to show their profits where they are taxed least heavily, rather than where they are earned. Transfer pricing was a common theme and many of the proposals focused on how companies should report ownership structures, profits/losses and the taxes paid on a country-by-country basis. Many groups recommended an "automatic information exchange" component in order to prevent transfer pricing abuses.

Transnational corporations need to be effectively taxed. To avoid paying taxes, TNCs have taken advantage of the considerable trade between their multiple affiliates and developed complex mispricing strategies. Country-by-country reporting as part of the international accounting standards for TNCs should be required in all sectors, as this would considerably curtail the possibilities for transfer pricing. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

States at comparable levels of economic development and in geographic proximity and regional economic groupings should harmonize their tax bases and minimum rates for corporate taxation.
[CIDSE]

Country by country reporting of accounts should be required of all TNCs, not only in the extractive sector. Host country requirements such as local purchasing and trade-balancing requirements, currently forbidden by the TRIMs [Trade Related Investment Measures] agreement, should be re-enabled, given their potential to prevent transfer pricing. [CIDSE]

A key component of the new international norm must be "automatic information exchange"... [C]ompanies must report their ownership structures and the total profits, losses and taxes they pay on a country-by-country basis. This way, individual countries could check that the right amount of tax had been paid on profits *originating in their countries and track the trade between subsidiaries and their parent companies. A new worldwide standard needs to be developed through the International Accounting Standards Board (IASB).* [ActionAid International]

Financial transaction taxes

A number of contributions focused on variant proposals to tax financial transactions (inspired from the original "Tobin Tax" proposal), either for regulatory or revenue raising purposes or both. Some focused exclusively on a Currency Transaction Tax (CTT) and others on a broader Financial Transaction Tax (FTT). The higher the tax rate, the higher its regulatory function was emphasized.

There can also be serious pursuit of a global tax on short-term financial flows, such as the Tobin Tax, where a small tax (say, 0.25%) is imposed on all cross-country currency transactions. This will penalize short-term speculators while it will have only a very small effect on genuine traders and long-term investors. The advantage is that not only will speculation be discouraged, but there can be greater transparency in the markets as movements of capital can be more easily traced. [Third World Network]

Regulate transnational capital by instituting a financial transaction tax. This would help to slow down international speculation and risky practices, reducing some of the chaos in current international commodity markets. [Maryknoll Office for Global Concerns]

A two-tier Currency Transaction Tax (CTT) would moderate the effects of speculative runs on currencies while generating revenue for development. It would so contribute to the prevention of major currency crises. The CTT's feasibility has been corroborated by many studies.... A more general Financial Transaction Tax (FTT) should tackle the financial instability that has been significantly exacerbated by the recent evolution of new financial instruments. The FTT could be levied on a whole range of financial transactions. It could be introduced step-by-step, first covering all transactions with financial assets, spots and derivatives in key financial centres, then expanding to broader geographical coverage. A FTT would stabilize excessively dynamic financial markets. As the tax base is the notional value of the respective transaction, the tax burden relative to the cash invested grows as the leverage effect rises. Such a FTT will specifically hamper those transactions that involve high leverage and therefore a high risk. A general FTT would make transactions more costly the shorter their time horizon is, hence it would tend to dampen technical trading. It can be expected to reduce excessive liquidity stemming from short-term oriented and destabilizing transactions. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

This CTT... would respond to the United Nations' General Secretary's concerns when he noted "renewed international interest in a possible currency-transaction 'development levy' of 0.005%, a minuscule tax [...] having the potential to generate billions of dollars that can be allocated for development. [...] Currency transaction taxes involve more than one country [... and] are best implemented in a cooperative manner among countries." [UBUNTU – World Forum of Civil Society Networks]

Governments, parliaments and global civil society [should] enact a very small global levy or tax on international currency transactions.... The revenues would be divided between global international institutions, regional bodies, and the parliaments of participating countries. Funds designated for the global international organizations would be deposited equally into ten or more "sectoral trust funds," including on peace and security, development and eradication of poverty, human rights, education, advancement of women, health and eradication of disease, environmental protection, children, disarmament, and debt relief. [World Federalist Movement - Institute for Global Policy]

II. RE-REGULATING FINANCE

Transparency and downscaling systemic risk

Many contributions called for greater transparency (which can only go hand-in-hand with decisive progress on secrecy jurisdictions and tax havens) and specific measures to scale-down or eliminate sources of systemic risk. Many stressed that transparency is necessary but not enough.

There should be greater transparency in the way the financial markets operate. There should be more disclosure of the players and the deals in the various markets, including the trade in currencies. In particular, the funds available to and the operations of highly leveraged institutions such as hedge funds should be made public.

At the global level, there should be a system of monitoring short-term capital flows, tracing the activities of the major players and institutions, so that the sources and movements of speculative capital can be publicly made known. [Third World Network]

All existing financial instruments need to be strictly regulated. Over-the-counter markets, in which derivatives and other "toxic" products are exchanged without any public control, should be prohibited. Under a safe regulatory regime, standardised derivatives could be traded at the stock market and would be strictly supervised. New financial instruments must be licensed by public authorities. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

[R]egulators need to be better trained to understand valuation problems for many types of securities and derivatives, including centralized [collateralized] debt obligations. New risk management techniques that can handle larger stress levels beyond arbitrarily determined standard deviations from historical averages need to be devised. New measures are also needed to regulate secondary markets, particularly bridging the gap between book values and mark-to-market pricing. [Women's Working Group on Financing for Development]

The possibility of a fiscal instrument which levies revenue proportionate to the level of risk taken by an institution should be explored. This would both de-incentivise high levels of risk and ensure that where risks are taken, the revenue system builds reserves to address potential negative fallout of those risks. [Christian Aid]

Curbing/eliminating speculation in commodity (staple food) and energy markets
With the dual food and energy price crises that preceded the full global impact of the financial crisis, many contributors emphasized special measures to curb or eliminate speculation on staple food and energy markets.

Excessive volatility of commodity prices or exchange rates, fuelled by speculation, is an important contributor to the crisis, with a serious adverse impact on development prospects of many poor countries. This problem must be addressed adequately by the Commission both in terms of prevention of speculation but also measures to bolster the resilience of poor countries and vulnerable populations. [Oxfam International]

Commodity index funds bundle up to 24 agricultural, energy, base and precious metal commodities. Agricultural commodities, the minor part of these funds, are subject to price swings driven by energy and mineral prices, endangering food security. The [Commission] should consider whether, in the absence of effective regulation, the funds should be banned. Fund trading at least should be subject to "circuit breakers" whenever extreme volatility impedes food security. [IATP]

A Tobin [Tax] variant could applied to commodities speculation, both to reduce the sometimes minute to minute trading that drives excessive speculation and to partly finance commodity exchange regulatory authorities. [IATP]

OTC [Over-the-Counter] trades of both commodities and financial derivatives form part of the mammoth "dark pools" of private and unregulated investments. Since OTC trades strongly influence prices in public exchanges, OTC trading data should be reported completely and promptly in all jurisdictions, so regulators can act promptly when traders exceed speculative position limits. Position limits should apply equally to all market participants, lest exemptions, exclusions and waivers for favored financial institutions result in financial institutions "too big to fail." [IATP]

How to deal with institutions "too big to fail"?
The global public goods nature of the financial system and its stability was emphasized by many participants, notably in terms of how to deal with "too big to fail" institutions.

Financial institutions that are "too big fail" and perform such a vital role for the real economy that deserve to be kept in business with taxpayers money, while the State takes the risk of guaranteeing deposits, ought to be in fact run under strict governmental supervision, with limits imposed on executive compensation and dividend payouts. The stakeholders that require losses to be socialized have no moral claim to privatize eventual profits and those institutions should thus be subject to the transparency and accountability rules of other State-run services. [Social Watch]
In the spirit of responsibility, no bank should be allowed to become "too big to fail." A bank which knows it will be "rewarded" with a bail out when systemic failure occurs, will not evaluate risk effectively. [Christian Aid]

Such social objectives as universal service should also be applied in other sectors which form part of the social infrastructure, and banking services, including international financial institutions, have a role to play in that respect, by extending *loans for investment purposes. To that end, the role of public banks needs to be re-emphasized to take account of the increasingly risk averse behaviour of the commercial banks. Faced by the triple requirements of resumption of lending, reduction of leverage/increased capitalisation and risk assessment /costing, there is as yet no sign that the commercial banks are responding adequately to the needs of poorer consumers, not just for FS [financial services] but also for all those other vital services to which their governments have committed in various ways. Yet such response is a necessary prerequisite for the massive public support which is being extended to the banks. Without such response it is hard to see any justification for the banks not being taken over by those without whose support they would founder. This is the logical conclusion of the "too big to fail" argument.* [Consumers International]

[T]he basic approach should initially be to return as much as possible of the [banking] industry to basic utility banking; strictly separating conservative money transmission and simple prudent lending where safety (neutral risk) is the prime consideration, from the potentially damaging speculative profit-making, which was introduced after the 1980s deregulation. The former should once more be limited to the traditional (pre-1980s) form of utility banking.... [Shaping Tomorrow Foresight Network]

Consumer Protection

Proactive, affirmative consumer protection is essential to safety and soundness of the financial system. The complex financial instruments that sparked the financial crisis were based on home loans that were poorly underwritten; unsuitable to the borrower; arranged by persons not bound to act in the best interest of the borrower; and with terms so complex that many individual homeowners had little opportunity to fully understand the nature or magnitude of the risks of these loans. [Consumers International]

No financial product should be offered to customers until it has been officially approved to be safe for consumers (no predatory lending) and not causing instability or "toxic" risks. [SOMO]

De-leveraging

International regulatory norms (i.e., in-capital requirements, accounting standards and transparency norms, limits on leverage, etc.) must be comprehensive in terms of the institutions covered. They should be applied not only to banks, but also to private equity funds, hedge funds, etc. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

Policy instruments similar to reserve requirements can be applied to derivatives, debt swaps, and hedge fund markets. Limits can be placed on leverage ratios. [Women's Working Group on Financing for Development]

From pro-cyclical to counter-cyclical regulation

Many contributors emphasized that the Basel II model of self-regulation has failed. Various proposals mentioned the need for counter-cyclical regulation.

The banking crisis is the result of a period of more than two decades in which financial institutions were able to create credit far beyond what responsible national *regulators would ordinarily have allowed. This led to a process of boom and bust. The boom characterised by high growth of consumption and by bubbles in unproductive assets, until eventually the bust feeds through from the banking sector into a sharp contraction in real economic activity.... The Basel II agreement for self regulation has demonstrated itself to be ineffective.... Regulation should have a strong counter-cyclical focus thus preventing excessive leverage and force the accumulation of increasing capital reserves during boom times.* [Christian Aid]

The pro-cyclicality of rules for banking supervision, embodied in Basel II, has also been recognized to have negative impacts on trade flows, inter alia, through increased pro-cyclicality of trade finance and credit for production, without which trade is not possible. Banking supervision should be rebuilt on different basis that accords more power to national supervisors to evaluate and regulate the capital requirements of banks in ways that are counter-cyclical and subordinated to the desired profile of production sought by a country. [International Working Group on Trade-Finance Linkages- Steering Committee]

Curb the capacity of banks to generate credit during expansions: Financial regulation in general, and in particular capital adequacy ratios, should be counter-cyclical: it should be tight in good times (storing up reserves and restraining risk exposure) and where necessary loose in bad times (facilitating lending, drawing on the reserves built up in good times). [WWF-UK]

Making finance work for people and the real economy

The orientation of accounting standards towards short-term speculative investors creates the valuation of assets that is based on market demand rather than "real" economic productivity. This leads to volatility in the prices of stocks, bonds, and other forms of investment, which can depart radically from their "real" value. [Christian Aid]

Changing regulatory and incentives structures for long-term goals

Many contributions provided ideas on how financial regulation can help re-orient incentives structures to longer-term societal goals and ensure greater equity in access to financial services.

[D]eveloping countries... must formulate a comprehensive policy to deal with the different kinds of capital flows. Such a framework may include a selective policy towards attracting FDI of the right type; a careful policy on portfolio investment that welcomes serious long-term investors but discourages or prohibits the damaging short-term profit-seekers; a very prudent policy towards public and private foreign loans; and measures that as far as possible avoid manipulative activities and institutions. [Third World Network]

Governance arrangements, human rights, employment, social and environmental assessments should form part of listing and reporting requirements for all companies. Investors should follow the UN Principles of Responsible Investment and include social, environmental and governance risk assessment in their investment practices... Rules must be formulated to discourage or ban short-term, non-productive or *damaging investment, while promoting longer-term socially productive and environmentally sustainable investment.* [SOLIDAR]

[Curb] corporate short-termism by strengthening governance and tax rules on executive compensation, board of directors' responsibilities, risk management and distribution of corporate profits. [ITUC and TUAC]

To guarantee financial stability, regulatory norms must include new and improved corporate governance standards (e.g., stronger representation of risk managers and stakeholders such as employee associations), as well more balanced incentive structures. Incentives encouraging managers to focus on short-term results and brokers to engage in risky, high-yield speculation must be limited. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

Finance ministries should be interested in capital gains taxes and how these might be used to change incentive structures, especially where profit generation from financial product innovation has focused on tax arbitrage and asset price bubbles. Corrective changes to the general tax structure also need to slow the trend towards "financialization," where financial products provide larger sources of profits compared with industrial goods and services production. [Women's Working Group on Financing for Development]

The International Accounting Standards Board should expand the definition of stakeholders beyond speculative investors to include all those affected by the activities of companies. Accounting standards should disclose and account for real economic productivity on a country-by-country basis... International Accounting standards should distinguish between speculation and enterprise. [Christian Aid]

[Give] a duty to regulators, supervisors to ensure that all financial services that finance or service operations, projects, investments, companies, production, trade, housing and consumption are promoting equity and sustainability, including full employment with decent jobs and income. In practice, clear criteria need to be introduced through laws (after public debates and parliamentary voting) for all financial activities and financial players so that financial products, financial transfers and all financial players only contribute to environmentally and socially sustainable activities, with priority to fight climate change and poverty. Regulators and supervisors have to ensure that all risk management mechanisms by all financial actors and all capital reserve requirements should include social and environmental risk calculations. Regulators and supervisors have to ensure that mechanisms and legally accepted criteria and processes are in place for green and social screening of clients/customers of banks. [SOMO]

Community reinvestment

There should be an international community reinvestment process so that all financial institutions that receive funds from investors in poor countries and emerging market economies should invest a portion of these assets back into projects and instruments from these countries.... The regulatory regime should require the financial institutions to demonstrate that they reinvested a stipulated portion of these assets in projects... that target poverty alleviation and meet certain social and environmental indicators. They should show that they aren't only investing in the largest and most *profitable projects in the developing world – which also often generate intense environmental and social concerns. If they aren't willing to invest in smaller, more targeted poverty alleviating projects, they should invest the funds in intermediaries that specialize in these projects.* [Centre for Human Rights, University of Pretoria]

Cooperative finance

Some contributions drew attention to the potential benefits of cooperative finance, but also how current international banking regulation is skewed against favouring the development of such alternative financial entities, as the following contribution from Banca Etica (Italy) testifies:

On the basis of our experience, we see that the present regulation system works to the disadvantage of the investments in small enterprises, social cooperatives, grassroots organisations. Our investments in social enterprises and cooperatives are considered, following Basel II, of maximum risk, because most of these enterprises are under capitalized. No international rating system takes into consideration the high social and environmental value of these enterprises: the creation of new jobs, the employment of disadvantaged people, the protection of traditional agriculture and biodiversity, the delivering of basic social services and so on...

Banca Etica's evaluation is not based exclusively on the capital asset of an enterprise, but we carry out a thorough analysis of its social and environmental sustainability, using various parameters such as working conditions, gender approach, use of renewable energy, internal democracy and so on.

However, this peculiar method of risk assessment is not recognized neither adopted by the financial regulators and supervisors.

Specific proposals:

- *to foresee in the Basel Agreement a specific regime for social enterprises and cooperatives;*
- *to include social and environment negative impact into the risk assessment.*

[Banca Etica]

There is also a case for regulation for the promotion of new institutions such as credit unions and other financial cooperatives, and the development of socially desirable objectives such as universal service and sustainable development. [Consumers International]

Towards better regulatory governance

Many of the proposals highlighted in this chapter imply better regulatory governance at national and international levels and perhaps new institutions such as the aforementioned call for an International Tax Organization. The broader governance questions will be dealt with in the next chapter on Multilateral Issues, including the proposal for a new institution for financial sector surveillance. Below are some highlights of comments and proposals related to improving regulatory governance, starting by changes that need to be brought to rating agencies.

Regulating rating agencies

Credit rating agencies share responsibility for backing the concealment of risks that led to the crisis and must be regulated and monitored by national governments in whose jurisdictions they operate. Legal incentives to rely on credit rating agencies should be removed from law, unless guaranteed by stepped up supervision by the government issuing such law. [CIDSE]

Establish international standards for rating and auditing system to equalize asset valuations of stocks, industrial sectors, and regional economies. Establish the rating agency as a public service that reports ratings and analysis openly. [Alsek Research]

[Address] the oligopolistic structure of the credit rating agency industry, including by establishing public agencies and developing non-financial sustainability rating. [ITUC and TUAC]

Credit and risk rating must be independent and well informed. A new and adequate theory of risk must be developed to help risk assessment over the long-term: this would allow independent experts to inform accordingly risk rating agencies. A proper regulation of all rating agencies is required in order to guarantee no conflict of interests. [WWF-UK]

There is a need to revamp the incentives structure within rating agencies so they produce more reliable assessments and introduce greater competition among what are few players. Proposals for a registry and oversight body should be studied.

There needs to be greater global cooperation among supervisors and regulators in existing fora and institutions, and eventually through setting up inclusive and comprehensive fora that can provide an effective public sector counterpart to what is now a private international financial sector, spot problems early on and call for regulatory reform on emerging areas of risk. [Erlassjahr-Year of Relief 2000]

Some highlighted the "revolving door" problem between regulators and rating agencies.

Closely related to the challenge of valuation is ratings classification, primarily led by credit ratings agencies, whose theoretical underpinnings are questionable. Regulators need to keep abreast of mechanisms so that they can in turn contribute to innovations in regulation. If lack of understanding is not the problem, then the revolving door employment among regulators, ratings agencies, and financial firms contributes to the loss of autonomy and independence that regulation requires, effectively resulting in de-facto self-regulation. [Women's Working Group on Financing for Development]

Global regulatory bodies

Some contributions focused on what they saw as democratic deficiencies in existing regulatory bodies, emphasizing the primary role of the UN in reforming and establishing global regulatory bodies.

Implement a global mechanism of State and citizen control of banks and financial institutions. Financial intermediation should be recognised as a public service that is guaranteed to all citizens in the world and should be taken out of free trade *agreements.* ["Let's put finance in its place!"; Belem 1 February 2009, NGO Sign-on Statement)]

The Basel II agreement for self regulation has demonstrated itself to be ineffective. Options for a democratised financial regulatory commission which monitors, regulates and has power to limit highly leveraged institutions should be explored. [Christian Aid]

A new regulatory regime must be established at the international level, universal in its geographical scope and comprehensive in terms of institutions and instruments regulated. Financial stability is a global public good.... The financial system reform must be led by the United Nations...The establishment of a new international regime requires global participation and democratic control. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

The General Assembly should affirm the authority of governments to enforce compliance with all financial market rules, including those of commodity exchanges. A public ombudsman should be created in each regulatory authority to provide "whistleblower" protection in the event of government abuse of regulatory authority and/or non- or inequitable enforcement. [IATP]

Avoiding financial crises requires global cross-border cooperation on supervision and regulation. Since the same governments that agreed to the [Monterrey] Consensus sit on the FSF [Financial Stability Forum], Basel Committees, and other bodies that set standards and codes, immediate steps should be taken by them to open these bodies' membership with the goal of achieving balanced, institutionalized and full participation by developing country governments. Standards and codes should no longer be part of IMF and World Bank conditionality and surveillance. [Erlassjahr-Year of Relief 2000]

A move away from self-regulation and strengthening regulatory mechanisms can help increase the transparency of the financial sector. We need to be mindful of the following: How do we allow for differences in the institutional structures across countries without resulting in uniform regulations nor regulatory competition; how do we allow for differences in regulatory structure given different levels of development of national financial sectors?; As we formulate global regulation on the financial sector, how do we consider differences in across countries' capacity to implement and enforce these rules?; How do we determine the impact of new financial products on the Central Bank's ability to control bank reserve requirements and maturity mismatches of assets and liabilities, including those related to capital account management? [Women's Working Group on Financing for Development]

THEME 2: MULTILATERAL ISSUES

Northern countries that have downgraded their commitment to the UN should reverse this attitude and, instead, affirm its indispensable and valuable role in advocating the social and developmental dimension in the process of rapid global change. [Third World Network]

Both the World Bank and the IMF must put an end to the economic policy conditionality that has characterised their interventions in developing countries over the past three decades. This has minimised rather than strengthened the application of fiduciary controls and respect for internationally agreed standards, including core labour standards. The deregulation, liberalisation and privatisation conditionalities of the IFIs, in addition to interfering with countries' own policy choices, have frequently led to serious and damaging impacts. [ITUC and TUAC]

Many of the respondents to Theme 2 demanded a broad and inclusive multilateral approach to reform in order to protect the rights of the world's poor, vulnerable, and under-represented. Several highlighted the interconnectedness and the weakness of the international economic system as shown by the speed and intensity from which the collapse in the US housing market spread to the rest of the world. Proposals ranged from strengthening the United Nations and its specialized agencies' role in global economic governance to drastically reducing the power of the Bretton Woods institutions and democratizing their governance. A common thread emerged from many of the submissions: ensuring that all global financial institutions are accountable, democratic in participation, transparent, and capable of linking economic policy with a broad range of issues to achieve socially desirable outcomes.

Placing the UN at the heart of the global reform process

Given the overwhelming consensus from civil society about the lack of representation in the international financial institutions, numerous organizations recommended that the United Nations, as the most globally representative body currently in existence, become the central institution coordinating global economic reform.

The negotiations on a new international financial and economic architecture need to be fully inclusive, therefore the United Nations must be at the heart of the negotiations, with the aim of introducing an equitable, sustainable financial architecture.... [Eurostep]

G7, G8 and G20: Lack of representation

Many commentators were critical of the ability of the G7, G8, and G20 to represent the world's interests; they instead favoured inclusive multilateralism for reform.

In order for developing countries to avoid bleak prospects in the 21st century, they must be given the space and opportunity to strengthen their economies and to develop their social infrastructure, while having environmentally sound practices. For this to happen, there has to be a much more favourable international environment, starting with the democratization of international relations and institutions, so that the South can have an active role in decision-making. [Third World Network]

We believe that reform of the international financial architecture requires the participation of the maximum number of stakeholders: governments from all countries, multilateral agencies and civil society, including women's rights groups. We agree with the Commission that "this unprecedented global financial and economic crisis requires an unprecedented global response," not of a G20 but of a G192. [WIDE]

The challenges the crisis has uncovered in global financial and economic governance calls for its overhaul. The G8 model is becoming archaic. The G20, while representing a greater part of the world's people, still leaves out 172 countries. [CIDSE]

So far there is little evidence that the G20 process will lead to real and effective action. In fact, there is a risk that the "G" groups are a mere window dressing exercise that leads to no reforms but marginalize the UN process. The Commission should ensure that its proposals will be taken into consideration by the G20 and the G8 and that the high level UN conference will indeed initiate a multilateral negotiation process around financial sector reforms and the role, governance and mandate of IFIs. [Oxfam International]

Strengthening the UN, ECOSOC and UN specialized agencies

Strengthening the United Nations' role in global economic governance emerged as a central theme for many organizations, particularly by empowering UN bodies, such as ECOSOC and UNCTAD, who are well-positioned to link economic policy with sustainable development, gender, environment, human rights and poverty eradication concerns.

As it is the most universal and democratic international forum, the United Nations and its agencies should be given the opportunity and resources to maintain their identity, have their approach and development focus reaffirmed, and strengthen their programmes and activities. The strong trend of removing the resources and authority of the UN in global economic and social issues, in favour of the Bretton Woods institutions and the WTO, should be reversed. [Third World Network]

Expertise should be built within the UN system, including UNDP and UNCTAD, in order to reduce reliance on the WB as the only "knowledge-technical assistance-capacity building" institution. The role and mandate of UNCTAD as an authoritative knowledge-based institution whose work aims to help shape current policy debates and thinking on development, with a particular focus on ensuring that domestic policies and international action are mutually supportive in bringing about sustainable development, including gender equality must be strengthened. The UN capacity can be enhanced through regional and national policy analysis and research centres linked with independent academic and non-governmental think tanks. [Women's Working Group on Financing for Development]

Within the UN it is essential to strengthen the different mechanisms that have been put in place to deliver on many of the important commitments on gender equality and women's rights made in several occasions, such as the BPfA [Beijing Platform for Action].... Furthermore, we also demand to strengthen the role and mandate of UNCTAD as an authoritative knowledge-based institution whose work aims to help *shape current policy debates and thinking on development, with a particular focus on ensuring that domestic policies and international action are mutually supportive in bringing about sustainable development, including gender equality.* [WIDE]

Bringing the BWIs under the United Nations

Numerous organizations recommended placing the Bretton Woods institutions under the control of the UN.

The BWIs must not become de facto organizations of governance in spheres for which they have no competence. Rather, these institutions must be subject to principles agreed by the international community, including the rules of international law that govern international economic relations, environmental protection measures, the protection of minorities and indigenous communities.... What is more, these institutions must be refounded within the United Nations, such that they become truly specialized bodies... of the UN system.... These refounded institutions would become part of a coherent world institutional architecture, which with a stronger, appropriately reformed and democratised UN would represent a solid and genuine example of global democratic governance. And these are the forums from which to undertake a thoroughgoing review of the direction of development assistance, in which donors and recipients, lenders and borrowers share in taking decisions, making commitments and allocating responsibilities. [UBUNTU – World Forum of Civil Society Networks]

UBUNTU also proposed specific roles for a UN-controlled IMF: multilaterally correcting world current-account and exchange-rate imbalances; supervise, control and regulate global movements of finance capital in order to prevent financial crises and ensure world macroeconomic stability; undertake ongoing surveillance activities over all economies; offset the growth of world financial imbalances by means of policy adjustments in the large economies (see also Chapter 4).

A UN Economic and Social Security Council

Many suggestions went beyond empowering ECOSOC and existing UN agencies or reforming the IFIs, to the establishment of a UN Economic and Social Security Council. Such an organization would act as an umbrella to coordinate global economic policy and create linkages with a broad range of issues.

The UN General Assembly, particularly through a strengthened ECOSOC or a UN Economic Security Council should be a forum for peer reviews of issues related to macroeconomic stability as well as supervise the actions and functions of the IMF (until its dissolution), the WB, and the WTO. The ECOSOC or UN Economic Security Council will need to increase its capacity to engage in discussion and debate over these issues. This approach must shift attention away from formula-based assessments such as the WB's CPIA and the use of policy conditionalities attached to lending and aid programmes. [Women's Working Group on Financing for Development]

We need policies that can build just, participatory and sustainable societies. This requires far-reaching reforms of the international financial architecture, which cannot be decided by the G8 or G20 alone, but needs response from the entire international community.... We therefore see an urgent need to create a so-called "Global Leaders Forum" under the UN or a UN "Economic and Social Security

Council" to coordinate policies and redesign the international system. [International Presentation Association of the Sisters of the Presentation]

The United Nations and its specialized agencies in the social, development, environmental, human rights, employment fields (including ECOSOC, DCF [Development Cooperation Forum], the Human Rights Council, ILO, UNEP, UNDP, UNIFEM) should be central to institutional arrangements for effective global governance to deliver social justice and a fair globalization. They should form the core of an Economic and Social Security Council that would be a convening authority to bring the key global governance actors together, with a strong coordinating role, linking the economic, financial and trading systems to policies for employment, development, environmental sustainability, gender justice, and poverty eradication. [ITUC and TUAC]

UN Parliamentary Assembly
Although many contributors recognized that the United Nations is the most representative international institution, a number of organizations recommended that its representativeness should be further strengthened. One organization advocated the establishment of a UN Parliamentary Assembly that could, among other things, *monitor the interlinkages and impact of the international system's financial and economic policies in other fields such as sustainable development, food supply, education, health or eradication of poverty... function as a watchdog ensuring that reforms and regulations are implemented effectively... and gather feedback from the grassroots level and civil society.* [Campaign for the Establishment of a UN Parliamentary Assembly]

New Institution for Financial Sector Surveillance
Another suggestion put forth was the establishment of a Financial Sector Surveillance institution (see also Chapter 1).

A new institution for financial sector surveillance, especially in developed countries whose financial sectors engage in heavy financial product innovation. This new institution could help neutralize the impact of credit rating agencies and other industry-based standards-setting bodies... undertake social monitoring... have full multi-disciplinary research support and be subject to full transparency. An independent evaluation unit should be tasked to design social impact assessments and early warning systems. Regular reporting to the public and to legislatures or national commissions as well as to the UN General Assembly and the ECOSOC is needed. [Women's Working Group on Financing for Development]

Other ideas proposed included some kind of a global taxation regime (see Chapter 1) and a fair and transparent orderly sovereign debt workout mechanism (see Chapter 4).

Reform of the IFIs
Various contributors urged reform of the governance structures of the international financial institutions, including the World Bank and the IMF.

The failure of existing institutions to manage the economy in such a way as to avoid social and environmental damage is intimately connected to their governance *structure.... It is critical that we see fundamental reform of the governance of international financial institutions, including the World Bank and the International Monetary Fund.* [WWF-UK]

The world is now changing, and a changing world requires either a completely new set of institutions or a massive overhaul of the governance of the existing multilateral institutions. [ActionAid International]

Radical reform of the international financial institutions is required if they are to play an effective role in enabling developing countries to manage their own development and sustainable economic growth. [Christian Aid]

Some suggested reform that would entail refocusing the BWIs on their original mandates.

The solution does not lie in increasing the authority of the WB and IMF as they presently stand, in granting these institutions greater control over social and economic development aspects, but in having their working remits refocused back onto their core responsibilities, the tasks for which they were conceived during their creation: providing a stable and orderly international trade and financial system, and facilitating reconstruction and development. [UBUNTU – World Forum of Civil Society Networks]

Another organization went a step further and recommended ending *the power of the multilateral Finance and Trade institutions such as the IMF, the World Bank Group, the regional banks and the WTO.* [Jubilee South]

Regional development banks should become more efficient and gradually replace the infrastructure and similar long-term development financing function of the IMF and World Bank. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

Others groups preferred a less radical approach and proposed ideas within the IMF/World Bank framework.

We believe that the current circumstances demand a root and branch reform of IFI governance structures rather than the creation of "islands of legitimacy" within discredited institutions. [ActionAid International]

Accountability, democracy and transparency

Many organizations emphasized the importance of making the IFIs, including their Boards, more accountable, democratic and transparent. [ActionAid International, Christian Aid, SOLIDAR, Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), Eurostep, Social Watch, CIDSE]

The IMF lacks political independence from its major equity holders. Current efforts to reform the IMF are unsatisfactory since benefits immediately accrue to the big countries, such as those in the G20, which still leaves out the LDCs and the SIDS. Strengthening the relationship between the BIS and the IMF will not accomplish the *desired need for independent oversight.* [Women's Working Group on Financing for Development]

Some suggested that increased accountability of the IFIs could be achieved by instituting parliamentary reviews of the BWIs.

Real democratic control over IMF and World Bank activities are crucial. It can be achieved through parliamentary reviews. Both institutions should make it mandatory for shareholders to certify that policy positions taken by the Board are regularly reviewed by a committee composed of members of national parliaments or by other representative bodies. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), SOLIDAR]

Other suggestions were made to enforce already existing IFI statutes:

Holding the BWIs financially accountable for damage done (as in tort law) is enshrined in their statutes. Simply by observing rather than breaching their own statutes, enormously positive effects on development can be achieved. Without this crucial change no reform can be meaningful as new rules would be broken as readily as existing ones. [University of Vienna - individual submission]

Recommendations to make the IFIs more democratic included taking up equal voting rights for developing countries, adopting double-majority voting, and civil society participation.

We need to put people first in reasserting democratic control over and full citizen's participation in public policies and the institutions that guide the global economy at international and national level. The markets need to be at the service of all people not just a happy few. [Eurostep]

To make the Boards of the IFIs more transparent and accountable, recommendations included alternating leadership of these institutions not just between developed countries, but among all countries [ActionAid International], selecting heads on merit (rather than nationality) and considering geographical diversity in selection procedures. [SOLIDAR]

Eliminate economic policy conditionality

Many participants also agreed upon the importance of eliminating economic policy conditionalities that the IFIs attach to their aid and lending programmes, which constrict policy space, [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), SOLIDAR, ITUC and TUAC, Christian Aid] *burden national economies and contribute to the violation of human rights (poor countries should no longer need to privatise basic social services or cut public sector spending as a precondition for receiving needed funds...)* [Eurostep] and *have frequently led to serious and damaging impacts.* [ITUC and TUAC]

The World Bank and IMF should both separate the provision of grants and loans from technical assistance and policy advice, as the latter is often used to restrict policy choices and reinforce conditions. [Christian Aid]

Reforming the mandates of the IFIs

For the World Bank, one specific proposal recommended: *The International Development Association (IDA) should become an independent grant-giving agency, allocating funding without economic conditions. International Bank for Reconstruction and Development (IBRD) should remain a loan agency, allocating loans without economic policy conditionality. There should be a separate governance structure, giving a more equal weight to customers (middle-income countries) and donors.... It should reform its structural conditions to recognise and reward the central role of the State in the regulation of capital flows and for the provision of essential services.*

The IMF should have a surveillance role to monitor markets and countries' economic policies, which have a potential negative impact on other countries. It should have an early warning system to predict future economic instability. In this regard, the Chiang Mai Initiative provides an example of a function and consensual surveillance mechanism.... The IMF should not provide long-term development lending to low-income countries and focus instead on balance of payments support and monitoring. It should act more like a central bank providing liquidity in an agile manner.... The IMF should expand its shock facility, through the issue of SDR, and ensure rapid disbursements to developing countries in need, unencumbered by structural conditionalities.... The IMF is well placed to assist developing countries strengthen their tax systems, including capacity to plug illicit capital flight and negotiate fairer sharing of natural resource rents. [Christian Aid]

Following the G20 Summit, it is clear that the Fund is going to continue operating in an expanded capacity. To be a legitimate and effective institution, the Fund must... embrace diverse economic philosophies to ensure policy analysis and recommendations derive from data not theory. [New Rules for Global Finance Coalition]

Inclusive policy approach

Many NGOs also stressed the need for broadening the policy frameworks of the IFIs to achieve socially desirable goals, including environmental sustainability, gender-sensitivity, human rights, decent employment and poverty eradication.

Human Rights, including gender equality, full employment and decent work and the necessary means to achieve "dignity for all," should not just be mentioned in the preamble of international agreements, but mechanisms should be put in place that ensure compliance and make global corporations and international organizations accountable to HR obligations. This includes preventing national policy space from being eroded by policy conditionalities that erode democratic governance mechanisms like parliamentary oversight. Lack of oversight and regulation by accountable authorities is one of the main causes of the present financial crisis. [Social Watch]

A key purpose... must be to ensure institutions have the capacity to embed environmental sustainability into the global economy. [WWF-UK]

Women's rights groups underscore the urgent need for a participatory, inclusive, concrete and democratic approach to the international economic and financial *system, with strong equal representation from all countries and from marginalized groups.* [Women's Working Group on Financing for Development]

All plans to reach international financial and monetary stability must be integrated into a broad gender-oriented and socially equitable framework. [WIDE]

In addition, ActionAid International argued that the IFIs *should give sufficient weight to full employment and the reduction of global imbalances in wealth and poverty.*

It is crucial to integrate all international trade and financial institutions into the international human rights system, and to make them submit to agreed instruments, including the Core Labour Standards of the ILO and environmental conventions. [WIDE]

IMF and World Bank should be held accountable to international human rights law, including the International Covenant on Economic, Social and Cultural Rights and the interpreting jurisprudence. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud)]

THEME 3: MACROECONOMIC ISSUES AND ADDRESSING THE CRISIS

There is a need for a new growth regime that – as was the case during the post-war period until the early 1980s – ensures balanced real wage growth in line with productivity increases. [ITUC and TUAC]

Most respondents to Theme 3 highlighted the need for governments to undertake new approaches to macroeconomic policy – particularly ones that are nuanced and responsible. In general, they viewed reforms to prevailing macroeconomic policy structures in the context of development and the provision of social protections, especially for the world's poor and vulnerable. Recommendations included policy reforms that specifically address the current financial, food and climate crises (for which the developing world played a minimal role in creating), and provided for social protections and new pathways to sustainable development.

The poor in developing countries will suffer most from the fallout of the global financial crisis for which they bear no responsibility. Export oriented economies are suffering from serious declines in trade credit and export demand, and a correction in asset prices. In addition, falling official development assistance (ODA), foreign direct investment (FDI) and flight of investment capital are leading to increased unemployment in developing countries. [Christian Aid]

Global Stimulus Package

A number of organizations recognized the importance of developed countries maintaining their current ODA commitments in order to ensure developing nations are able to successfully cope with the current economic crisis. Several submissions suggested that not only should current ODA commitments be maintained, but that developing countries should be offered a "global stimulus package." Suggestions for innovative mechanism of financial stimulus – and financing for development more broadly – were discussed under Theme 1 (see Chapter 1).

Compensate developing countries for the devastating impact of the financial crisis on income and employment, by providing a recovery package worth at least $400bn over the next three years. The reduction in GDP growth rates caused by the crisis is going to cost developing countries $750bn by the end of 2010, according to IMF. There is an urgent need for a recovery package for the poorest countries. It will help some 80 countries through the financial crisis and is less than 10% of what the US and EU have already spent bailing out the banks. Such a compensation and stimulus package could include frontloading of 2010 aid pledges and enhanced debt cancellation.

Such a package will enable developing countries to mount their own fiscal stimulus efforts through investment in sectors with high social and economic multiplier effects such as agriculture and land reform, education, health, climate adaptation, and social protection. Maintaining and expanding government spending in these sectors is urgently necessary in the short term to curb the devastating loss of human capital and rise in inequality that the current global recession will otherwise unleash. [ActionAid International]

Meanwhile, national efforts to provide stimulus can be complemented by "global stimulus," such as increased spending on MDGs and other global problems. ODA is both safety net and fiscal stimulus. The provision of aid should be based on the principle of Self-Sufficiency and Solidarity. This is grounded in the commitment among and between developing countries in terms of ensuring food security/national self-sufficiency & access to medicine and access to investment & technology necessary for development. It also includes solidarity and partnership between developed and developing countries in terms of the flow of technology, investment and overseas development assistance, fair and balanced trade rules and the flexibility for developing countries in pursuing macroeconomic policies. This requires plenty of policy space. [Women's Working Group on Financing for Development],

Some envisioned a specific role for the IFIs in the stimulus:

The international community must swiftly expand emergency loans through the IMF and increase assistance from the World Bank and UN agencies to the many developing and emerging countries that are likely to be in situations of balance-of-payments deficits because of the financial crisis and continued high food and fuel prices. [ITUC and TUAC]

Many also offered suggestions on the type of projects to prioritize:

Urge the World Bank to give priority to projects that are employment-intensive, extend social safety nets to the majority of developing-country workers currently without protection, build up public services and infrastructure for sustainable growth. [SOLIDAR]

However, most were quick to caution that any new assistance – particularly from the World Bank and the IMF – should not follow the "one-size-fits-all" approach of the past and emphasized that sufficient policy space should be made available to recipient countries:

The set of macroeconomic policies that forms a key part of the so-called "Washington Consensus" (that puts the stress on "getting prices right," withdrawal of the State from the economy and economic policy-making, heavy reliance on the free market, deregulation, privatization and liberalization, austerity budgets and high interest rates) has been at the centre of conditionalities attached to IMF and World Bank loans for indebted countries. These policies came under heavy criticism, especially in the wake of the Asian crisis and are now widely discredited as the current crisis unfolds. The "one-size-fits-all" approach towards economic reform and policy for countries in financial crisis should be changed to a more appropriate approach of seeking the right mix of policies to suit the particular conditions facing each country. Such conditions may vary from country to country, and thus the policy mix may also be different for different cases. Thus, the framework for macroeconomic policy advice or conditionality should be reformed to take into account these differences, and in light of lessons to be learnt about which strategies have and have not worked in different circumstances. Countries must have the flexibility to choose from policy options, as it is not appropriate to present them with advice or conditions based on a single model or option. [Third World Network]

Most developing countries are operating pro-cyclically, often through no fault of their own, but because they are pressured by the IFIs to practice "fiscal discipline." The international community must be more supportive of recovery programmes implemented by developing countries, which can prevent poverty from growing further and accelerate the global recovery, and this requires increased financial assistance from IFIs and donor countries. [ITUC and TUAC]

The deregulation, liberalization and privatization conditionalities of the IFIs, in addition to interfering with countries' own policy choices, have frequently led to serious and damaging impacts. [Instead], *financial support to countries... should protect employment and social safety nets. It should be provided quickly to help boost demand, and stimulate growth.* [ITUC and TUAC]

Debt Cancellation to help counter-cyclical measures
A number of organizations argued that debt relief is critical to cope with the crisis in the short term and to promote growth in the long-term. New debt should not be incurred by developing countries, nor should it carry new conditionalities, in their efforts to deal with the current global economic crisis.

A new package of debt cancellation would release funds in developing countries which can be used to stimulate the economy and provide social protection to the most vulnerable, as is being done in the North. Eligibility for debt cancellation should be based on a measure of debt sustainability connected to human development, which would mean much greater debt cancellation for many more countries. [Jubilee Debt Campaign UK]

Debt cancellation should be expanded to all the world's most impoverished countries (IDA only) without harmful conditions. The serious hardships imposed on middle- and low-income countries by the global financial crisis demand such a move. Furthermore, the increasing debt levels in developing countries over the past year are not the consequence of domestic policy failures, but rather are the result of exogenous causes including shocks in energy and food prices and now erosion of export earnings because of financial turmoil originating in developed countries. Developing countries should not have to shoulder the financial burden of debt that has been caused by exogenous and imported crises. [Health GAP, on behalf of a US civil society coalition]

Trade dimensions of financial stimulus
Many submissions questioned the prevailing global trade paradigm and cited it as a major cause of the current crisis:

From a macroeconomic perspective, the impacts of the crisis on developing countries can be attributed to several macroeconomic difficulties stemming from movements in their current accounts. Reform proposals that tackle macroeconomic policy-making should deliberately focus on generating an environment more conducive to different patterns of trade, with more balanced domestic and external market dynamics.

The source of woes for many developing countries is the implementation of a model of reforms that gave centrality to a paradigm of export-led growth while not ensuring *the financial gains derived from exports ultimately accrue to them. This model of export-led reforms did not take into consideration the importance of ensuring that trade became a means for the stable provision of development finance or the need for its articulation with the domestic economy.* [International Working Group on Trade-Finance Linkages- Steering Committee]

Indeed, for many, the current crisis has exposed export-led growth as a failed development model. To illustrate this point, one submission noted that: *Trade-related macroeconomic difficulties are not confined to the current account. The patterns of foreign capital inflows were also tied, in more or less direct ways, to the high rates of export growth. Rather than generate income growth, they tended to reinforce unhealthy patterns of export-related income growth. Now, at a time that the situation has reversed, with the prices of natural resources falling, retreating investment is showing also its destabilizing face. This retreat should not be seen as a withdrawal merely symmetrical to the increase in resources that were originally brought by foreign investors. While investment in the good times was able to ride on a number of State guarantees and subsidies, including regulatory and tax concessions, pro-investment reforms skewed the sharing of the profits away from the national economy.* [International Working Group on Trade-Finance Linkages]

The balance between interior and exterior markets needs to be revised, with the aim of revitalizing the domestic demand. The crisis revealed the decay in growth policies based on export focused approaches and over-reliance on foreign direct investment. [Arab NGO Network for Development]

Moreover, there are many social dimensions to trade liberalization:

The prevailing assumption by mainstream economists that trade liberalisation is a gender neutral process that increases overall prosperity and wellbeing overlooks the deleterious social impacts from greater dependence of the global market. The proliferation of wide-ranging and ambitious bilateral free trade agreements, which serves mainly developed countries' business interests at the expenses of local people's livelihoods must be reviewed. The often adverse, differential impacts of economic liberalisation on women relative to men are not sufficiently taken into account. It is essential to establish coherence between the global commitments to gender and social equality, women's rights, environmental protection and international trade policies. [Women's Working Group on Financing for Development]

...all world leaders must take this opportunity to step back and develop a fresh approach to the global trading system that prioritises justice and equity, including enforceable language on labour and environmental standards, and which builds economic relationships fit to deal with the triple financial, climate and food crises of the 21st century. This new approach to global trade must work in the interests of people and the environment whilst strengthening local and regional supply chains and ensuring dialogue and cooperation at the international level. [WWF-UK]

Therefore, for those that addressed trade, the most important issue was that trade agreements allow developing countries the necessary policy space to undertake counter-cyclical measures that will allow them to better cope not only with the current crisis but to also implement policies and programmes that can allow for improved social protection and development.

Developing country governments' scope to use trade policy to safeguard vulnerable sectors and promote development should be enhanced. Developing countries should have the right to develop and protect small-scale agriculture to promote food security, livelihood security and rural development.... Rich countries must avoid financial and trade protectionism, which will have a negative impact on developing countries. [ActionAid International]

Trade and investment policies must recognise policy space and regulatory capacities of governments to shape economic and social development policies that serve the most vulnerable of their societies. They should support local and regional production, exchange and supply, as the basis of needs and rights oriented provisioning and trade. [WIDE]

In this vein, current trade negotiations should be revisited or, in the view of some, suspended:

The financial service liberalization and deregulation measures included in bilateral and multilateral trade and investment agreements need to be reviewed. The Doha Round trade negotiations should separate the financial services agreements from the "single undertaking" package, so that any gains for developing countries in market access are not undermined by the increased vulnerability introduced by being forced to resign to key financial control and oversight mechanisms.

All current trade negotiations both on the multilateral and bilateral level must be put on hold until the necessary firewalls to protect the financial system from future shocks are put into place, and until a better understanding is reached on the links between trade policy and financial stability at this moment. Both bilateral and multilateral (GATS) trade agreements that call for the deregulation of financial services and the elimination of performance requirements for foreign investments should be renegotiated. [Social Watch]

Moreover, trade agreements should allow countries to develop more diverse trade profiles:

As critical aspects of generating more resilient macroeconomic policy frameworks in developing countries the Commission should emphasize the importance of measures to diversify trade profiles (both products and markets), manage investment, rebalance profit- and loss-sharing in infrastructure lending, extract a fair share of export income and encourage investment in the development of local processing infrastructure in area of origin of natural resources. [International Working Group on Trade-Finance Linkages- Steering Committee]

In addition, the current crisis should not give rise to aggressive protectionist measures on the part of developed countries, particularly policies that would weaken the trade capacities of developing countries:

Developed countries must refrain from imposing barriers to international commerce in an effort to protect their economies by impoverishing those of poorer countries. [NGO Committee on Financing for Development]

PRO-EMPLOYMENT AND DEVELOPMENT STRATEGIES

Pro-employment and development macroeconomic policies were seen to play a critical role in effectively combating the current economic crisis. In particular, central banks had to include these broader objectives in their mandate.

Ensuring that central banks are publicly accountable for their actions, have governance structures that allow for trade union views to be taken on board, incorporate the realization of full employment among their primary objectives, and have the necessary mandate to deter and detect speculative financial bubbles. [ITUC and TUAC]

It was also noted that central banks must play a crucial role in directing savings to development and environmental objectives:

Central banks can also be involved in credit allocation to influence where savings may be invested but also to support the work of government-owned or controlled banks, such as land banks, development banks, export-import banks, among others. These latter set of banks have specific development mandates such that central banks need to be more conscious of the balancing act that they do with respect to price stability and its relationship with other development goals. A final consideration is the role of the central bank in promoting financial sector deepening and capital market development. Regulatory structures need to be aware that in developing countries more work needs to be done to bridge the gap between micro-finance and banking and investment sectors. Given these other responsibilities, central banks need to be encouraged to report their activities to legislative bodies and the general public. [Women's Working Group on Financing for Development]

Central banks had to be made publicly accountable.

[C]entral banks must become publicly accountable and dependent on publicly democratic political institutions. [SOMO]

Another organization argued that governments should *overhaul central banks in line with democratically determined social, environmental and expansionary (to counter the recession) objectives, and make them publicly accountable institutions.* [Focus on the Global South]

Moreover, fiscal and monetary policies had to be pro-employment and targeted at the "real economy."

Fiscal stabilizers such as unemployment benefit schemes must be strengthened and supplemented by direct job creation schemes, where necessary. Fiscal stimuli should target increases in aggregate demand of sufficient magnitude to revitalize the real economy: employment, wage and household disposable income growth. Tax and expenditure measures must be targeted at low and middle income families who are *suffering most in the current situation and who, having higher consumption rates, will feed this back into consumption, production and hence employment most rapidly.*

In developing and emerging countries, governments should counter economic slowdown through monetary policy, by supporting job creation programmes and extending or creating social safety nets. [ITUC and TUAC]

Investing in people and the planet: Public provision of social and environmental services and protections

Anti-cyclical stimulus packages to reactivate the economy should at the same time invest in human resources, by improving the educational and health infrastructure and the provision of essential services like clean water, sanitation and electricity. [Social Watch]

Almost all submissions raised concern over the well-being of people all over the world in the wake of the current crisis. They argued that social protections – often the first victim of budget cuts – should instead be expanded in this time of crisis. In fact, many further argued that these measures will have a positive long-term impact on the development of all countries.

Invest in people – their education and health, and in care for the very young and old – by strengthening public provision of essential services to ensure universal access to education, basic health care, water and housing, and to increase secure jobs and pensions within the public sector, as well as train the millions of teachers and instructors necessary to provide the education and skills that underpin the real economy and for retraining of working people as economies restructure; in the North, take up the slack in the construction industry to meet historic, current and future demand by investing in social housing, whilst supporting governments in the South to do the same. [SOLIDAR]

Building, re-building, and strengthening social insurance systems, safety nets and social protection need are needed. This is not to preclude the design of policies that will take countries to the point where they are able to achieve universal social provisioning. [Women's Working Group on Financing for Development]

Gender dimensions

Traditionally vulnerable populations were of great concern to many respondents. Several pointed to the precarious position of women:

Access to finance for women and the provision of health insurance – including access to reproductive health care services, maternity benefits, affordable child care – is also critical. This must go well beyond the common practice of opening channels for women to access micro-credits and must take into consideration and tackle structural inequalities that have prevented many women and other marginalized groups from accessing funding and loans. [Women's Working Group on Financing for Development]

Women often work in the "unpaid" or informal sector and therefore:

New indicators must be developed to measure the impact of gender inequality on economic growth by measuring the value of women's unpaid work as well as by developing performance indicators to measure progress in introducing and implementing gender-responsive approach to public finances.... The connection between paid and unpaid work is still ignored and the shift in costs from the paid to the unpaid sector leads to increased burdens for women. It is important to pay attention to the imbalance between the productive economy and the reproductive economy or care economy, which is largely dependent on women who function continuously in spite of crisis as if their capacity and the capacity of households are elastic. [Women's Working Group on Financing for Development]

In addressing this crisis WIDE demands policy coherence that ensures "a critical and socially progressive linkage between social policy, macroeconomic policy and development." This will require going beyond the MDGs and being accountable to agreed women's rights frameworks such as the Beijing Platform for Action (BPfA) or the Convention on the Elimination of All Forms of Discrimination against Women. [WIDE]

Links between the food, climate and financial crises

Several respondents noted linkages between the "food crisis" and the current financial crisis and suggested strategies for addressing the former in the context of the latter.

Agree emergency responses to the continuing food crisis, including action to counter speculation in food markets and to extend emergency support to the poorest; support the expansion of sustainable food production and small-scale agriculture. [SOLIDAR]

One organization argued that responses to the current global food and climate crises should not be financed through loans.

The food crisis and the climate crisis render peoples of the South, and in particular women who dominate the food sector, more vulnerable to the accumulation of new loans. Financing to address the food and climate crises should not be in the form of loans. Governments should not offer or enter into loan-financing for seed purchases and other food and agriculture programmes, or loan-financing of climate mitigation and adaptation mechanisms.... Other problems that cause the huge flow of resources out of developing countries should be addressed, as these contribute to increasing the debt burden, erode the benefits of debt cancellation and lead to the re-accumulation of debt. These include unfair trade agreements, tax holidays for multinational corporations, unregulated profit remittances and capital flows. [South-North International Campaign on Illegitimate Debt]

Investing in the transition to a green global economy

Organizations also urged the rebuilding of a green global economy in order to preserve global resources and allow for future generations to continue growth.

Any national monetary and fiscal measures to boost the global economy will fail in the medium and long term if they are not founded on the principle of environmental sustainability. Capital investment must be used to tackle climate change and build energy security by driving forward the transition to a low carbon and resource-

efficient global economy. Specific measures should include major public investment in renewable energy production, infrastructure and research; energy and resource efficiency programmes; retrofitting existing private and public buildings with insulation and efficient heating and cooling systems; ensuring new publicly funded developments are to the highest energy efficiency specifications; incentivising private sector energy and resource efficiency; education and training for environmentally sustainable development; improvement, electrification and decarbonisation of public transport systems; reuse, remanufacturing and recycling technologies for all waste. [WWF-UK]

Rebuild a green global economy that respects and preserves our global common goods, prevents further global warming and ensures a sustainable, safe and clean environment for future generations. The introduction of a carbon tax, in this context, can be an efficient measure not just to combat global warming but also to compensate developing countries for the additional asymmetries created by increased subsidies and protectionism in developed countries. [Social Watch]

Pensions

Some respondents highlighted pensions as a social protection measure of particular importance.

To be effective, it is important that social protection schemes are not made over-complicated. Universal pension programmes... are the simplest social protection schemes to implement and can reach a significant proportion of vulnerable families. Putting in place more complicated social protection systems – such as means-tested programmes and conditional cash transfers – stretches the capacity of developing country governments and evidence indicates that they are likely to fail in achieving their target of benefiting the poorest families. [HelpAge International]

Citing the example of New Zealand, this NGO noted that not only are national pension schemes feasible and provide an important social safety net for older persons, but they can also help to stimulate the economy:

There is strong evidence that non-contributory pension schemes that reach all older people are very effective in reducing poverty among older people and their families. Based on the model of the New Zealand pension scheme – which, according to the OECD, has been the most effective public pension scheme in reducing old age poverty among developed countries. National pension schemes have a critical role in stimulating the national economy. [HelpAge International]

Other groups noted that any pension scheme should be stable and participatory:

Promoting workers' representation in pension funds and (financial) companies' boards and ensuring they have a say in investment decisions.... Enhancing the social purpose of pension schemes to provide decent retirement in both pension funding and investment regulations. [ITUC and TUAC]

Ensure stability for ordinary investment such as pension funds and health insurance. [ActionAid International]

THEME 4: REFORMING THE GLOBAL FINANCIAL ARCHITECTURE

Solutions to the present crises should not be premised on re-establishing or saving a failed system, but on changing it. The UN can and must rise to this occasion. [Jubilee South]

I. A NEW ARCHITECTURE FOR SOVEREIGN DEBT

A fair and transparent orderly sovereign debt workout mechanism

Many called for a fair and transparent orderly debt workout mechanism which was strongly supported by the G77 group of developing countries at the 2008 UN Financing for Development conference in Doha. [Eurostep, Women's Working Group on Financing for Development, Jubilee South, Jubilee Debt Campaign UK, SOMO, erlassjahr.de ("International Insolvency Framework")]

Existing arenas for addressing debt disputes are dominated by lenders, where they serve as both interested parties and judges. There must be a new forum to which debt disputes can be brought, where parties are given equal treatment and judgements are based on impartial evaluation of cases. [South-North Campaign on Illegitimate Debt]

Included was the proposal for a "debt standstill and orderly debt workout mechanism" detailed by UNCTAD in its Trade and Development Report 1998 in the wake of the East Asian crisis. It would imply that a country could declare a standstill on payment and be allowed time to work out a restructuring of its loans, while creditors would agree to this "breathing space" instead of trying to enforce payment. This proposal is an extension of national bankruptcy procedures (similar to Chapter 11 of the United States Bankruptcy Code) to the international level for countries facing debt difficulties. [Third World Network] Some suggested that internationalizing Chapter 9 of the same code (focusing on US municipal insolvency) was more appropriate as it applies to public borrowing entities. [University of Vienna - individual submission]

A moratorium on all sovereign debt payments should be undertaken, without needing to wait for a balance of payments crisis as a trigger. [Women's Working Group on Financing for Development]

Cancelling odious and illegitimate debt

Many suggestions emphasized the new debt architecture should address "odious and illegitimate debt," a concept that received growing legal and political interest and recognition. A number of submissions noted recent precedents:

- The justification for the cancellation of Iraq's debt focused on the odiousness of the previous Iraqi government.
- Norway's unilateral decision to cancel several claims on the basis of "failed development policy" and "co-responsibility" was a historic precedent, and has already opened up discussions on odious or illegitimate debt in international arenas including UNCTAD, the World Bank, and the Paris Club.

[Women's Working Group on Financing for Development, Jubilee South, South-North Campaign on Illegitimate Debt]

[The UN should] address the issue of social, historic and ecological debts, in the context of responding to the crises-provoked needs and the challenges of long-term system transformation. An important way of responding to the needs of those peoples and countries in situation of poverty or exclusion, heightened now by the impact of the global crises, is not through "more aid" but by recognizing the existence of these debts to the peoples and countries of the South and taking action to secure restitution and reparations. [Jubilee South]

Comprehensive country debt audits
The comprehensive debt audit conducted by Ecuador and the suspension of payments on some claims subject to further investigation were cited by many contributors as a model the UN should encourage and support. [Jubilee South, South-North Campaign on Illegitimate Debt, Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), CIDSE]

We urge the UN to encourage and support comprehensive country debt audits. Comprehensive debt audits, both governmental as well as independent citizens' audits, are useful tools for not only for uncovering the impact of the debts and the nature of the debts. Audits can also address the structural and policy flaws that have led to the accumulation of unsustainable and illegitimate debt. The government of Ecuador is leading the way by launching the first official country debt audit process. [South-North Campaign on Illegitimate Debt]

Audits are important tools for popular movements, citizens and governments to evaluate the impact and legitimacy of the system of indebtedness and to establish the basis for sanctioning those responsible for illegitimate and illicit actions, recovering what has been unjustly collected or stolen, and instituting new alternatives for the sovereign control over financial resources. In the present crisis conjuncture, and as a necessary step toward any transformation in the international monetary and financial system, the realization of comprehensive country-based audits, articulated regionally and/or globally, can be a powerful tool for galvanizing public debate and participation in the processes of change as well as impacting in the balance of forces opposed to such change. [Jubilee South]

Curbing vulture funds
A number of debt campaign networks also urged action against so-called "vulture funds," which buy up debts at a steep discount and pursue the debtor country for the full amount, often through the courts.

In the current system, vulture funds act as "rogue creditors" by taking advantage of funds freed up by the debt restructuring negotiated by other creditors, taking their claims to court with the goal of winning full repayment and more. [Jubilee USA Network]

Proposals included legally limiting the amount of money a fund can make on sovereign debt to drastically reduce "the incentive for hedge funds to pursue vulture activity." The limit for profits could be the purchase price of the debt plus a *reasonable rate of interest. As most vultures sue in courts in the United States, the UK and France, laws limiting profits in those countries would be a significant step toward curtailing vulture activity. Creditors should also be persuaded not to on-sell claims. In a May 2007 press release, Paris Club countries committed not to sell their claims on HIPC countries to creditors who do not intend to provide debt relief under the HIPC initiative. However, until more creditors agree to participate and sign onto the commitment, it will do little to prevent vulture activity. Creditor countries outside the Paris Club should sign a pledge similar to the Paris Club commitment not to on–sell sovereign debt owed by low-income countries.* [Jubilee USA Network]

This aggressive approach is typical of the rogue behaviour that has been exposed in the financial markets in recent months, where pursuit of profit has been put before the sorts of values, such as human development and freedom from poverty, to which the market must be made to serve. [Jubilee Debt Campaign UK]

Redefining the debt sustainability framework

There was a wide call to review and redefine the Debt Sustainability Framework, involving not only governments but also civil society and giving centrality to human development goals and human rights, including gender equality and women's empowerment.

As a result of the current economic downturn, there is a great probability that many developing countries will be forced to default on their debt repayments. Despite the various multilateral and bilateral debt relief operations, developing country external debt increased to US$ 3.35 trillion in 2008. The Debt Sustainability Framework (DSF) of the IMF and World Bank has been ineffective...

A different approach to comprehensively address the process of borrowing and lending is needed. Responsible lending must be the cornerstone and can only be achieved by the adoption of a binding legal framework that deters creditors from engaging in irresponsible lending. The international community has repeatedly issued calls for more responsible lending for several years, including at G8 Summits, in the G20, in the OECD and in the UN General Assembly. Such a framework would take account of both the origin and impact of the debts and offer equal treatment to both debtors and creditors, ultimately affecting the incentives not only for debtors, but also for lenders, and preventing renewed indebtedness on a sustained basis. The framework could be in the form of an impartial and transparent process for resolving debt crises and disputes. The EURODAD Charter of Responsible Financing (2008), which outlines the essential components of a responsible loan, is an important step towards this goal. [Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), CIDSE]

A systematic and rigorous criteria to assess the impact of the execution of debt repayments and structural reform programmes on the realization of fundamental economic, social and cultural rights, as provided for in the international human rights instruments is needed. [Women's Working Group on Financing for Development]

Eligibility for debt relief should be expanded to all countries that need it to meet the MDGs. [Jubilee USA Network]

A common platform or covenant for principled and responsible financing
Beyond redefining debt sustainability, proposals included a different approach to comprehensively address the process of borrowing and lending, both in terms of quantity and quality to guide implementation of a sovereign debt workout mechanism.

The international community has increasingly issued calls for more "responsible lending" in the past several years, including at G8 summits, in the G20, at the Organisation for Economic Co-operation and Development (OECD), and in the United Nations General Assembly. It is clear that we must tackle the problem of debt accumulation and re-accumulation in a forward-looking way that looks comprehensively at borrowing and lending and locates these processes in the broader context of the international financial system. We urge the UN to begin a process of developing a common platform or code, which should involve not only Member States but also civil society organizations. [South-North Campaign on Illegitimate Debt]

II. REDRESSING GLOBAL IMBALANCES AND ASYMMETRIES

Many contributions proposed various measures to address global imbalances and asymmetries in the global economy that contributed to the current and past crises and reinforced global inequities, notably in terms of South-North net financial flows and unequal capabilities in crisis response. These proposals were often couched in insisting on the need to understand imbalances and asymmetries from a broader perspective than is commonly discussed in financial architecture policy debates.

Recovery packages should be designed to redress the underlying fundamental economic imbalances that have produced the current crises. These are notably the imbalance between the US and other parts of the global economy, the imbalance between finance and the real economy and the imbalance of bargaining power between workers and their employers. Those economies that have surpluses should redirect them to supporting domestic consumption and productive investment. Trade union rights should be fully respected and promoted so that workers can improve their living standards. [ITUC and TUAC]

Dealing with exchange rate gyrations
A number of contributions identified sharp gyrations in exchange rates as a major source of instability and inequity, affecting trade relations often more fundamentally than trade determinants on the official trade agenda, calling for the UN to play a leading role in addressing this perennial issue.

Given the wild swings of exchange rates in some currencies, it is not tenable to hold that currency movements are only reflections of changes in fundamental market values of these currencies. Instability of currency rates has become a major contributing factor to overall financial instability...As part of a reform of the international financial architecture, a more stable system of currency exchange rates needs to be established...The root of the problem lies in failure to establish a stable international system of exchange rates after the breakdown of the Bretton Woods arrangements in the 1970s. Yet the need to establish a global system of exchange rates is not even on the agenda for reform of the international financial architecture."

Third World Network's research project on financial policies in Asia (2007-2009) suggests that are serious dangers of divergent movements in exchange rates within Asia, which could lead to destructive "beggar-thy-neighbour" policies in the region. This concern is reflected in other developing regions and on a global level as well. It is hoped that the Commission's recommendations will help bring multilateral and regional approaches to exchange rate management onto the financial architecture reform agenda, including by considering UNCTAD's recent proposals to that effect [a multilateral exchange rate regime to stave off currency speculation]. [Third World Network]

The original Bretton Woods system was conceived as a complement to the multilateral trade system, which in order to properly function required a certain degree of exchange rate stability. The IMF was originally created to perform such function but, since the fall of the par value Bretton Woods system in the 1970s, instability and misalignments of currency exchange rates have become the norm. Increased levels of exchange rate volatility have a strong impact on trade performance through channels such as the levels of domestic investment, the variations of relative prices of export products (which, in turn, affect competitiveness of the economies), the price of access to finance for production. The value of market access concessions and price-based trade liberalization measures that receive so much attention in trade negotiations has been at times dramatically reduced or become uncertain due to the exchange rate fluctuations. These changes, it is worth noting, do not affect all countries equally, having asymmetric impacts on the trade performance of developing countries, as compared to developed ones.

Not only has the IMF lost this function with the fall of the Bretton Wood system in the 1970s, but we are of the view it is in no position to regain capacity to perform such function in the future. There is more than enough evidence of this in failed attempts of the last ten years, first through the "spillover" assessment in Art. IV consultations, later through the "multilateral consultations on surveillance."

There is an urgent need to establish alternative credible mechanisms for the multilateral management of exchange rates. Establishing an institution concerned with orderly coordination among hard currency issuers is a desirable goal but the issues above are likely to remain as long as the domestic currency of a country continues to be used widely as main international trading and reserve currency. So steps should be taken to move towards a system that relies on a multilateral currency for trading and reserve purposes.

Strengthened regional and sub-regional schemes for monetary cooperation hold the key to lower dependence on the currencies of a few dominant countries. Ultimately, a more balanced and development friendly system for multilateral management of exchange rates will be one that builds on, and seeks to gradually coordinate, South-South regional currencies and currency units.

Indeed, multilateral exchange rate coordination is more feasible, as a first step, at the regional or sub-regional level, and it would lead, by supporting intra-regional trade, to diversifying trade products and markets, thereby deepening the resilience of developing country economies to external shocks like the current one.

All these reforms, however, are likely to take a long time. Some degree of currency exchange rate instability will presumably continue to exist, leaving non-reserve currency countries to disproportionately bear its impacts, so a regular and predictable mechanism to ensure that developing countries can opt-out of their trade obligations to the extent required to compensate for such impacts on their economies should also be set in place. By the same token, while global institutions to manage exchange rates of trend-makers are missing, it is all the more necessary that trend-takers (mostly poor and undiversified economies) can enjoy the necessary space to manage their exchange rates. [International Working Group on Trade-Finance Linkages- Steering Committee]

Regional monetary and reserve arrangements

Regional approaches as an alternative or stepping stone to multilateral exchange rate stabilization were emphasized by a number of participants, often described in the context of more comprehensive regional development agendas, including the *Banco del Sur* in Latin America, and regional currency arrangements and reserve pooling, notably the "Ecuadorian proposal" involving intensified regional monetary cooperation towards regional exchange rate mechanisms, the pooling of reserves and their convertibility into a new regional currency. [Oxfam International, Women's Working Group on Financing for Development, Jubilee South, Bread for all (on behalf of Bread for all, Swiss Catholic Lenten Fund, Alliance Sud), CIDSE)

Implement an international monetary system based on a new system of reserves, including the creation of regional reserve currencies in order to end the current supremacy of the dollar and to ensure international financial stability. ["Let's put finance in its place!" Call for the signature of NGOs, trade unions and social movements, Belem, 1 February 2009, over 360 signatures)

An international financial facility funded by countries with excess reserves has merits but should not preclude work being done on regional monetary arrangements, such as the Chiang Mai Initiative, the Bahrain Initiative or the Ecuadorian proposal. Among these efforts, the bilateral and multilateral currency swaps are a cooperative approach to deal with reserve imbalances although there has been relatively little take up on this as the aforementioned initiatives take time to mature. Policy conditionalities should not be used on these occasions. [Women's Working Group on Financing for Development]

Support the construction of autonomous, regionally-based financing for development institutions and mechanisms based on economic, social, ecological, gender and intergenerational justice. The creation of ALBA, Peoples' Trade Agreements, and other South-South alliances of solidarity and complementarity, including also the South Bank and other new monetary and financial stabilization arrangements in South America, are potential avenues for confronting the consequences of the crises, recovering sovereignty and opening new horizons of more fundamental change. [Jubilee South]

A new global reserve system?

A few participants contributed and commented on proposals for more fundamental global financial architecture reform involving the creation of a new global reserve system to anchor exchange rates, with "seigniorage" (emission) capacities, and involving symmetrical disciplines on surplus and deficit countries.

Proposals ranged from the IMF issuing Special Drawing Rights for financial and currency stabilization as well as development objectives [Christian Aid] to the establishment of an International Money Clearing Unit (IMCU) that only central banks would hold among nations that would abide by the rules of a clearing union system. This system would involve symmetrical responsibilities among surplus and deficit countries of the kind John Maynard Keynes had proposed but failed to achieve at the 1944 Bretton Woods Conference. [*Journal of Post-Keynesian Economics* – submission by the Editor]

Others remained more circumspect about such global monetary solutions:

It is very difficult to support proposals to establish single global currency given the structural inequalities in powers that would affect decisions over issuance and control of the global currency. The issuance of Special Drawing Rights may be tainted by the IMF's loss of credibility. There have also been proposals to use a GDP-weighted basket of real exchange rates (also known as a world currency unit) as an anchor for the world's currencies. This currency unit helps reduce sovereign risk because it is standardized and inflation adjusted. The suggestion is to link this currency unit the domestic currency board or trade-weighted basket of currencies. It will still be difficult to currencies to work with. The question remains how economies become systemically significant enough for their currencies to command confidence in the international monetary system. [Women's Working Group on Financing for Development]

A key question in the possible move to a new system of fixed exchange rates was how the initial rate of each country would be set in the context of power imbalances associated with asymmetric currency values. Until such political obstacles could be surmounted, many preferred regional approaches, and insisted on the priority of re-legitimizing capital controls (or "capital management techniques") at the national/regional level and in the global policy/regulatory environment as an immediate means to manage destabilizing capital movements (including speculative attacks on national currencies), screen the quality of capital entries and prevent capital flight, as discussed in the Chapter 1 on Financial Regulation. [Third World Network, Social Watch, Women's Working Group on Financing for Development, SOMO, Oxfam International]

List of Civil Society Contributors

(In an order beginning with the last submission received first)

1. SustainUS
2. Women's Working Group on Financing for Development
3. International Trade Union Confederation (ITUC) and The Trade Union Advisory Committee (TUAC)
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6. Servas International
7. Servas
8. RESULTS Educational Fund and Canter for Economic Governance and AIDS in Africa
9. Health GAP (Global Access Project), on behalf of a U.S. civil society coalition
10. Centre for Research on Multinational Corporations (SOMO)
11. Social Watch
12. Nord Sud XXI
13. International Working Group on Trade-Finance Linkages- Steering Committee
14. Institute for Agriculture and Trade Policy (IATP)
15. Consejo De Desarrollo Socioeconomico Para Sudamerica Codesesa
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17. Alsek Research
18. The Oil Drum
19. Christian Aid
20. Central Única dos Trabalhadores (CUT) Brazil
21. Bretton Woods Project
22. NGO Committee for Social Development
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24. Association for Protection of Environment and culture
25. Erlassjahr-Year of Relief 2000
26. European Solidarity Towards Equal Participation of People (Eurostep)
27. Fondation Charles Leopold Mayer
28. World Federation of United Nations Associations (WFUNA)
29. Friends of the Earth - Latvia
30. World Council of Churches
31. European Network on Debt and Development (EURODAD)
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44. The Eastern African Sub-regional Support Initiative for the Advancement of Women
45. Cooperation Internationale pour le Developpement et la Solidarite (CIDSE)
46. Deutscher Naturschutzring e.V.
47. UBUNTU - World Forum of Civil Society Networks
48. International Movement ATD Fourth World
49. HelpAge International
50. Neighbourhood community network

51. Focus on the Global South
52. Tax Justice Network
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59. International Gender and Trade Network (IGTN)-Afrique
60. Shaping Tomorrow Foresight Network
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62. OneAim.org
63. Consumers International
64. Working for a Sane Alternative
65. Banktrack
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93. Financial Transparancy Awareness
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About NGLS:

The United Nations´ Non-Governmental Liaison Service (NGLS) promotes constructive relations between the United Nations, governments and a growing range of non-state actors, in particular civil society organizations. By providing strategic information, analysis and support, NGLS is part of the United Nations´ efforts to build coherence around cross-cutting and emerging issues on the UN´s agenda; to strengthen multistakeholder policy dialogue; and to ensure meaningful civil society engagement in UN processes.

NGLS set up a special website for this process. This website contains many of the submissions received in their entirety. It can be viewed at www.un-ngls.org/cfr

World Food
Programme

25 March 2009

General Assembly
Interactive Thematic Dialogue
On the Financial and Economic Crisis and its Impact on Development

New York
25-27 March 2009
Statement by Deborah Saidy, Director, WFP New York Office

WFP expresses its appreciation to the President of the General Assembly for convening this important and timely dialogue on the global financial crisis and its impact.

If there is one message we want to convey, it is this: The food crisis is not over. In fact, food prices remain high relative to historical levels. Of even greater concern is the fact that as the global financial crisis deepens, hunger and malnutrition are likely to increase as the purchasing power of the poor diminishes due to reduced incomes and higher unemployment.

While the hungry poor may be least responsible for having set the financial crisis in motion, they are also the least protected from its negative impacts. In the industrialized world, people experiencing hardship will often have a range of social securities to fall back on – a family loan, investments, unemployment insurance, perhaps welfare benefits. In contrast, among the bottom billion, savings and any productive economic assets have, in many cases, already been drawn down to mitigate the effects of the recent high food and fuel crises.

WFP has the ability to play its part in easing the situation for the worst affected. In 2008, we assisted nearly 100 million persons, clearly demonstrating the ability to rapidly scale up to meet the challenge of high food prices, proliferating emergencies and the constant need to assess emerging vulnerabilities, adapt and respond. We are most grateful to the national governments, donors and partners who supported us in these efforts.

The question for 2009 is: will we be supported and get the resources to meet the even greater challenge this year? WFP has been called the insurance system for the world's hungry. But there is no insurance for the insurer. We depend totally on voluntary contributions to support the "human rescue package" of $5.2 billion which we launched earlier this year. We call on the world to once again show that together, we can ensure that the most vulnerable are not forgotten.

This is not only the right thing to do. It is the smart thing to do. There is widespread recognition that the economic crisis has an impact on the poor. But there is less appreciation for the fact there is an economic as well as a human cost to hunger. There is much evidence that under-nutrition in the first years of a child's life can permanently stunt mental and physical growth – diminishing learning and earning potential later in life. Recent research which WFP undertook in Latin America with the Economic Commission for Latin America and the Caribbean assessed the economic costs of child under-nutrition: it estimated total losses for seven regional countries at a staggering \$6.6 billion for a single year (2004) – an average of 6 percent of GDP.

Neglecting hunger and food security could exacerbate the current situation and have dire social, economic and political consequences. Are we going to wait for more evidence or are we going to act? WFP is consulting at country level to determine how best we can assist countries to mitigate the impact of the current convergence of crises on hungry households, in close cooperation with other UN agencies and partners.

Among the range of initiatives already undertaken, we are expanding urgently needed food and nutritional assistance safety nets, cash and voucher programmes, supporting local purchses from small farmers and helping them to afford inputs and sustain livelihoods. We also continue to play an active role in the High Level Task Force on the Global Food Security Crisis, under the dynamic and dedicated leadership of the Secretary-General.

A background paper providing more information on WFP perspectives on the impact of the global economic crisis on hunger and food security is available in the chamber.

Thank you for allowing us the opportunity to participate in this important dialogue.

Regional dimension of the crisis

Interactive Thematic Dialogue
On the Financial and Economic Crisis and its impact on Development. 25-27 March 2009

ECLAC

Contents

- The global context
- The regional impacts and expected effects
- Responses

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The global context

- The consensus forecast shows that world growth will register a contraction in 2009.
  - The expected contraction ranges from -0.5% (IMF forecast) to -2.9% (JP Morgan).
- Driven by a contraction in global demand, which will be reflected in the largest contraction in world exports since the Second World War.
  - World exports are expected to contract by 9% in 2009, WTO.
- The world economy is expected to recover in 2010 provided:
  - Adequate policies to stabilize financial conditions.
  - Adequate fiscal stimulus.
  - Improvement in credit conditions.

3

The regional impacts and expected effects

Impact of the financial crisis on emerging market economies…

- As things stand, the consensus forecast suggest that emerging market economies will register a significant slowdown in their growth trajectory.

- And that the main challenges faced by emerging market economies growth thus far are:
  - Tightening of external financial conditions.
  - Declining commodity prices.
  - Weak and weakening external demand.
  - Countries capacity to finance counter-cyclical policies.

5

Developing economies have experienced restricted access to external finance…

Private Flows
(Billion of US$)

	2007	2008	2009
LAC	183.6	89.0	43.1
Emerging Europe	392.8	254.2	30.2
Africa and Middle East	37.4	26.4	27.2
Emerging Asia	314.8	96.2	64.9

Source: Institute of International Finance, January 2009

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Also exports of goods and services have been affected...

- Reduction in exports of goods and services.
  - The WTO estimates a 9% global trade decline for 2009.
  - Significant reduction in commodities prices.

Exports real value
(Growth rate)

	2006	2007	2008
LAC	4.0	3.0	1.5
Emerging Europe	6.0	7.5	6.0
Africa	1.5	4.5	3.0
Middle East	3.0	4.0	3.0
Emerging Asia	13.5	11.5	4.5

Source: WTO

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The dynamic of GDP will be significantly affected in 2009, but there is optimism about 2010...

GDP
(Growth rate)

	2008	2009	2010
LAC	3.9	-2.2	3.0
Emerging Europe	4.2	-2.6	1.3
Emerging Asia	3.9	0.2	5.0

Source: JP Morgan

8

Financial conditions of developing economies have deteriorated…

- After the intensification of the financial crisis in September last year:
  - Exchange rate markets have turned more unstable.
  - Equity markets experienced a strong downward adjustment.
  - Country risk spreads spiked.
  - The stock of international reserves either stopped growing or decreased.
  - Credit growth has slowed down considerably in most developing economies.

9

Impact of the financial crisis on the most vulnerable sectors of society…

- Experience from past crises show that they have negative effects on poverty and welfare, and tend to slowdown progress towards the MDGs.
- Unemployment rates are increasing, together with real wages reduction impede households ability to provide adequate food and necessities.
- Employment is shifting from dynamic exports oriented sectors to low productivity informal sectors.
- Declining in remittance and migrant return could undermine poverty gains.

10

Responses at the regional level

Fiscal stimulus plans

- To boost aggregate demand and for social protection.
- Asia:
  - Asian economies have the capacity to undertake counter-cyclical fiscal policies.
    - China announced in November the largest fiscal stimulus package (USD 586 billion) in Asia (about 13% of GDP), second only to the US package in size.
- Middle East:
  - Several countries, including Egypt, Saudi Arabia, and the UAE have adopted expansionary fiscal policies to boost domestic demand.
- LAC:
  - Argentina, Bolivia, Brazil, Chile, Colombia, Mexico, Panama, Paraguay and Peru have also announced fiscal plans to boost aggregate demand.

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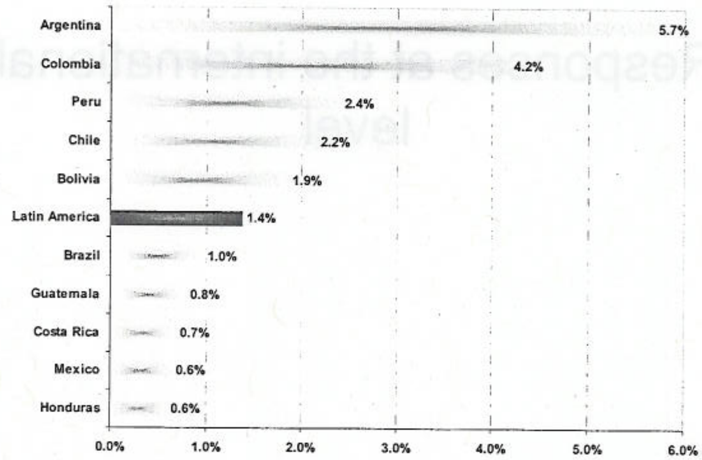
Fiscal package stimulus in LAC (% of GDP)



13

Financial cooperation

- Assistance of regional financial institutions.
  - Africa:
    - ➢ African Development Bank has set up a US$1.5 billion Trade Finance Facility to support trade and investment in Africa.
    - ➢ The ECA, in collaboration with the African Union Commission and the African Development Bank, organized a High-Level Forum which resulted in the creation of a Committee of Ten Ministers of Finance and Central Bank Governors to recommend measures to be taken at the national, regional, and international levels to mitigate the effect of the crisis on African economies.
  - Asia:
    - ➢ Current crisis has highlighted the need for regional coordination and cooperation. For example, ASEAN+3 have agreed on a multilateral reserves pool to increase the availability of funds and to reduce the amount of precautionary funds held by each country as a defense mechanism against short-term capital flows.
  - LAC:
    - ➢ Support of Andean Corporation, IADB and Latin American Reserve Fund. US$ 10 billion.

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Responses at the international level

Developing economies require the provision of counter-cyclical liquidity on a global scale…

- Enhance IMF and other global institutions (World Bank), lending capacity (capital and leverage).
  - ✓ The disposal of 250 billion are insufficient to cover the eventual liquidity needs of large countries.
- Short-term liquidity facilities must be strengthen with light-conditionality.
- New lending facilities.
  - ✓ The United Nations has proposed a credit line facility funded by those emerging economies that have accumulated substantial stocks of international reserves.
- Regional initiatives to complement global arrangements.
- Central Banks swaps.

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The needed reforms of the international financial architecture

- The current situation provides a window of opportunity to move towards a more equitable and stable financial system.
  - ➢ The international community has the responsibility to ensure that this does not become a missed opportunity.
- Restoring efficiency, trust and legitimacy to the international financial system.
- The new financial architecture should reduce systemic risk and improve governance.

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The needed reforms of the international financial architecture

- The reduction of systemic risk entails:
  - ➢ Liquidity facility as a permanent component.
  - ➢ The consideration of surveillance as a public good.
  - ➢ A consistent and widely accepted regulation and supervision framework is required.
- Improvement in governance requires:
  - ➢ Incorporate the demands and adequate representation of developed and developing countries.
  - ➢ Reflect the current and growing role of emerging market economies.
  - ➢ Include an active role for the United Nations and other Bretton Woods institutions.

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General Assembly Extraordinary Interactive Thematic Dialogue on The World Financial and Economic Crisis and Its Impact on Development

Statement: Ms. Jane Stewart,
Special Representative and Director,
ILO Office to the United Nations

President d'Escoto, Excellencies, distinguished delegates, colleagues, ladies and gentlemen:

The ILO appreciates the opportunity to participate in this curtain-raiser event, through which we can both lend support to the preparatory process for the future United Nations conference currently being planned by the General Assembly, and provide 1) ILO's perspective on some contributing factors to the current crisis; 2) An assessment of the impact on employment and the real economy; 3) Reminders of lessons learned from past financial and economic crises; 4) And some suggestions as to the way forward.

Let me begin by saying that the Director General is unable to be here today as our own Governing Body is meeting this week to discuss the outcomes of four regional meetings we held on the crisis in Santiago, Manila, Addis Ababa and Lisbon and fine-tune a decent work response to the crisis. You will know of course, that the members of the ILO and its Governing Body are your colleagues in the employment, labour and social affairs ministries and the representatives of employers' organization and trade unions – the real economy if you like.

Contributing Factors to the Crisis

Prior to the onset of the sub-prime mortgage bust, they expressed concern over the imbalances that the process of globalization was generating. The ILO convened 2004 World Commission Report on A Fair Globalization, stated that the present course of globalization was not economically or socially sustainable. While the world economy was experiencing consecutive years of robust growth, the benefits were not being shared by all.

As noted in the ILO December 2008 World of Work and Global Wage Reports, during the two decades that preceded this crisis, the incomes of richer groups grew faster than those of middle- and low-income groups. The wage share of growth continued to decline despite improved productivity. A rise in the share of indebted households has been observed in all countries where income inequality has increased. In short, stagnating wages and incomes for a majority of workers have spurred demand for credit to sustain consumption and housing investments. This, in conjunction with lightly regulated financial practices that allowed for excessive debt accumulation and focussed on short term returns rather than long term investments in the economy lies at the heart of the current crisis.

The Impact on Employment

Now, the crisis has taken on its own dynamics and is dramatically impacting employment, business prospects and social stability. In developed countries there is a vicious circle of negative interactions between financial markets, product markets, trade and labour markets. Jobs losses are leading to lower consumption, which lowers industrial confidence leading to less investment and resulting in more job losses.

In developing countries, multiple transmission mechanisms including reducing trade flows, declining commodity prices, reduced liquidity and tightening of credit markets, reduced flows of remittances, drop in FDI and declining flows of ODA are increasing levels of vulnerable employment and the numbers of working poor.

After four years of consecutive declines, the global unemployment rate increased to 6 per cent in 2008, up from 5.7 per cent in 2007, and the number of unemployed rose by 11 million in near immediate reaction to the market meltdown.

The January 2009 ILO Global Employment Trends indicates that based on growth projections, the global number of unemployed persons could rise by 20 million in 2009. If the outlook worsens to the point where increases in unemployment match the magnitude witnessed in the 1990s, then unemployment could rise by 50 million, bringing the global unemployment rate above 7 per cent.

In terms of those who are already vulnerable such as women, youth and migrants, we anticipate that 22 million more women will join the ranks of the unemployed in comparison with 2007. Latin America and Caribbean women will be the hardest hit with a 1.9 per cent increase from 2007 to 11.0 percent or roughly 3 million additionally unemployed. In 1999 roughly 71 million youth were unemployed, whereas in 2007 about 73 million were unemployed. Our worst case scenario suggests that 15 million more youth will be unemployed in comparison with 2007 reaching a total of 88 million unemployed youth in 2009.

Countries and persons that rely on remittances from abroad are also already seeing significant declines. A reversal in rural to urban migration flows has been noted in China and, and in Africa, workers who had formal jobs in export oriented sectors have been pushed back to the informal economy where they will be less protected and earn lower wages.

As you know, for developing countries the unemployment rate is not a good indicator of the labour market situation, because lack of social protection and unemployment insurance does not allow people the option, or "luxury", of being unemployed. Instead, they have to work to survive in the informal economy and at low levels of income. This is why it is important to have additional indicators, such as the working poor or vulnerable employment. Many of those that lose their jobs do not become officially unemployed but underemployed or precariously and unproductively employed.

We anticipate vulnerable employment to increase by some 25 million. We are seeing substantial downward pressure on informal-economy wages, which before the crisis were already declining and are substantially lower than those of regular workers. This downward pressure may push some 200 million back into extreme poverty negating all progress on poverty eradication since the introduction of the MDGs.

Of note, with the predicted order of magnitude this crisis will take Sub-Saharan Africa back to the levels of working poor and vulnerable employment that it had in 1999, erasing a decade of progress towards lifting people out of poverty in the region. South Asia is one of the regions with the largest increase in extreme working poor in 2009, with an increase of more than 13 percentage points from 2007.

In terms of business, SMEs account for up to 95 per cent of enterprises and are responsible for most existing and new jobs. However, tighter lending standards present particular challenges for SMEs given their reliance on bank credits – they do not have access to capital markets in the same way larger firms do. In the US, about 80 per cent of lenders have tightened their standards for lending to SMEs and about 60 per cent in the European Union.

Against the backdrop of the pre-crisis expansionary period, in which gains were unevenly shared, the economic and social costs of the crisis are noticeably widespread. Perceptions of unfairness are mounting, increasing the risk of social instability. With limited or no social protection coverage, the labour market recession will lead to significant social hardship for millions of workers left without adequate support including unemployment insurance, health care, access to training, education, lack of or loss of retirement savings. Some countries are already seeing social unrest in the form of strikes and demonstrations.

Lessons learned from Previous Crises

History proves that successful stimulus packages must be rapidly implemented, substantial and sustainable. According to an ILO simulation, assuming that credit markets were restored, it would take one year for the United States economy to recover if the proposed stimulus package was implemented now. It would take almost two years if implementation of the package were delayed by three months.

Everything we know about past economic crises shows that their social impact will be significant and long lasting. We also know from previous crises that it can take 2 to 3 times longer to reach pre-crisis employment levels than to restore economic growth-with the employment impact from banking-related crises often being particularly deep and prolonged. Earlier crises caused on average, a drop in GDP for approximately 2 years and increases in unemployment for a much longer period of 4 to 5 years.

As important as it is to respond to the needs of the financial system, it is urgent that public investment respond to the needs of people. Fiscal stimulus packages and finance sector reform are best explained and justified in terms of their impact on jobs. This message resonates strongly with the political instincts of Presidents and Prime Ministers whose speeches on the crisis are almost always focused on tackling the jobs crisis.

In this context, the ILO is proposing the creation of a global jobs pact that recognizes:

- That the more central decent work is in expansionary policy, the greater the economic stimulus
- That the crisis should be looked at from the perspective of not only restoring growth but as an opportunity for transformative action in supportive of the greening of the economy and increased social justice
- That solutions must be nationally and globally coordinated with full participation of social partners and civil society

<u>Elements of the Jobs Pact:</u> Making Decent Work the cornerstone of fiscal stimulus:

1. **Focus on Enterprise and Human Resource Development:**
   - Restore credit to SMEs: Support for smaller enterprises often squeezed hardest in the credit crunch helps preserve employment for the upturn.
   - Rapid labour market assessments: need to be available for countries to make best policy decisions
   - Job-rich infrastructure: Labour intensive infrastructure investment is vital at the present time and should also help restructure towards a low carbon economic development path.
   - Employment services: Support jobseekers through employment guarantees, conditional cash benefits. Increased investment in training and skill development likewise can help reduce unemployment and prepare for recovery.
   - Creating broader-based Social Protection: This is vital as unemployment and working poverty mount. Social protection is key part of a social floor and provides a purchasing power floor to the recession.
   - Special approach for youth needed: Keep a focus on the eradication of child labour, support continued education, and effective labour market schemes
2. **Avoiding wage deflation and protecting workers' rights:**
   - Wages to rise with productivity, with minimum wage nominal and real: We must link better productivity to salaries and growth to employment.
   - Promoting social dialogue about wages and working conditions: Social dialogue and collective bargaining are extremely valuable mechanisms for finding ways to survive the crisis and build for the recovery which reflect both employers and workers need for a sensible balance of flexibility and security.
   - Avoiding race to bottom in workers' rights: Now is not the time to economize on respect for labour standards especially fundamental principles and rights at work. The harsh reality is that it is the workers with the least protection who are being pushed out first – migrant workers, temporary and short term contract workers, younger and older workers. Principles like equality of opportunity and freedom of association will be tested by hard times but if we let them slip the consequences in terms of social hardship and tensions will be severe.
   - Ensuring women not affected disproportionately
3. **Promote international coordination in policy responses:**
   - Avoid protectionist solutions: Focus on root causes of the crisis not reactionary responses
   - Engage dialogue between ILO, IMF, UNDP, UNEP, WB and WTO on reforms of financial architecture; ways to achieve a more balanced, fair globalization; and the fight against climate change
4. **Global Jobs Fund: A counter-cyclical global mechanism is need for countries with little or no fiscal space.**

The credit from the Fund should not be subject to the condition that social protection and minimum wages be cut but instead be used to revitalize the economy through investments that strengthen development prospects

Conclusion

The multilateral system is well placed to find and champion the mechanisms that focus on people and on the real economy and which can avert the risks of prolonged labour market and enduring social crises. We must return to the basic function of finance, which is to promote the real economy. To lend so that entrepreneurs can invest, innovate, produce jobs and goods and services. We need to get the balance right and concentrate on rescuing people and production.

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

7 January 2009

Excellencies,

I have the honour of submitting for your review a statement prepared by the Commission of Experts on Reforms of the International Monetary and Financial System following its first meeting in New York City, 4-6 January 2009.

As noted in my communication of 28 November 2008, the Commission of Experts was convened to prepare a set of comprehensive recommendations by March 2009 that would assist the United Nations General Assembly in defining its approach to increasing the stability and equity of the global financial system.

The enclosed statement, containing 11 recommendations for immediate action, reflects the deliberations of the first of three formal meetings of the 18-member Commission.

In the statement, the Commission calls upon all nations to pay careful attention to the potentially harmful impact on the developing countries of the stimulative policies that the developed countries are taking in the face of global economic and financial crisis.

The Commission also draws attention to the need to address asymmetries in the capacities of the developed and developing nations to adopt counter-cyclical policies in the face of deepening global economic and financial crisis.

Finally, to assure that the burden of economic adjustment does not fall disproportionately on the world's most vulnerable populations, the Commission stresses the urgency of identifying or creating facilities for channeling resources to countries that need liquidity to offset the collapse of global demand for emerging countries' goods and services.

The next formal meeting of the Commission will be held in Geneva on 8-10 March 2009.

Please accept, Excellencies, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

All Permanent Representatives and
Permanent Observers to the United Nations
United Nations Headquarters, New York

Office of the President
63rd Session of the General Assembly

MEMBERS OF THE COMMISSION OF EXPERTS OF THE PRESIDENT OF THE UN GENERAL ASSEMBLY ON REFORMS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

1. **Mr. Joseph Stiglitz** (USA) (Chair) Nobel Prize in Economic Sciences (2001). Former Senior Vice President and Chief Economist of the World Bank.

2. **Mr. Jean-Paul Fitoussi** (France) Professor of Economics at the Institut d'Etudes Politiques de Paris since 1982. Currently President of the Scientific Council of the Institut d'Etudes Politiques de Paris and President of the Observatoire Français des Conjunctures Economiques.

3. **Mr. Charles A. E. Goodhart** (UK) Norman Sosnow Professor of Banking and Finance, London School of Economics. Former Chief Advisor to the Bank of England and member of its Monetary Policy Committee.

4. **Mr. Pedro Páez** (Ecuador). Minister for Economic Coordination.

5. **Mr. Jomo Kwame Sundaram** (United Nations) Assistant Secretary-General for Economic Development, United Nations Department of Economics and Social Affairs.

6. **Mr. José Antonio Ocampo** (Colombia) Former UN Under-Secretary-General for Economic and Social Affairs and Finance Minister, Colombia. Currently Professor, School of International and Public Affairs, Columbia University.

7. **Mr. Avinash Persaud** (Barbados) Chairman of Intelligence Capital Limited. Member of council, London School of Economics. Founding director of the Global Association of Risk Professionals.

8. **Mr. Yaga Venugopal Reddy** (India) Former Governor of the Reserve Bank of India.

9. **Ms. Zeti Akhtar Aziz** (Malaysia) Governor and Chairman, Central Bank of Malaysia.

10. **Mr. Eisuke Sakakibara** (Japan) Former Vice Minister of Finance for International Affairs. Currently Professor at Waseda University, Tokyo.

11. **Mr. Chukwuma Soludo** (Nigeria) Governor, Central Bank of Nigeria.

12. **Mr. Yu Yongding** (China) Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences. Former Member of Monetary Policy Committee, People's Bank of China.

13. **Ms. Heidemarie Wieczorek-Zeul** (Germany) Federal Minister of Cooperation and Development.

14. **Mr. Yousef Boutros-Ghali**, Egypt. Minister of Finance. Chair of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund.

15. **Mr. Rubens Ricupero** (Brazil) Former Secretary-General of UNTACD. Former Minister of Finance of Brazil.

16. **Mr. Robert Johnson** (USA) Former Chief Economist of the US Senate Banking Committee and former Senior Economist of the U.S. Senate Budget Committee. Former managing director at Soros Fund Management. Member of the Board of Directors of the Economic Policy Institute and the Institute for America's Future.

17. **Mr. Andrei Bougrov** (Russia) Managing Director and member of the Board of Directors of the Interros Company. Former Principal Resident Representative of Russia, Executive Director and member of the Board of Directors of the International Bank for Reconstruction and Development.

18. **Mr. Benno Ndulo** (Tanzania) Governor of the Bank of Tanzania.

Rapporteur
Mr. Jan Kregel. Former UNDESA staff; now University of Kansas and the Levy Economics Institute of Bard College.

The Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System

Recommendations for Immediate Action

The Commission held its first meeting in New York on January 4 through January 6.

The current financial crisis, which began in the United States, then spread to Europe, has now become global. Even emerging markets and less developed countries that managed their economy relatively well, resisted the bad lending practices, held high levels of foreign exchange reserves, did not purchase toxic mortgages, and did not allow their banks to engage in excessive risk taking through derivatives and excessive leverage have become embroiled and are likely to suffer as a result. *Any global solution—short term measures to stabilize the current situation and long term measures to make another recurrence less likely—must pay due attention to the impact on these countries.* Without doing so, global economic stability cannot be restored and economic growth, as well as poverty reduction worldwide will be threatened.

This unprecedented global financial and economic crisis requires an unprecedented global response. It requires a response not just from the G-7, G-8, G-10, or G-20, but from the entire international community, the G-192. This gives especial importance to this initiative of the President of the General Assembly, which has received so much support from around the world.

The Commission began its work, seeking to identify the underlying factors that have contributed to the magnitude of the crisis and its rapid spread around the world and broad principles underlying needed institutional reforms required to ensure sustained global economic progress and stability, which will be of benefit to all countries, developed and less developed.

Reforms and regulations have a goal: the better functioning of the world economic system for mankind's global good. This entails simultaneously pursuing long term objectives, such as sustainable and equitable growth, the responsible use of natural resources, and reduction of greenhouse gas emissions, and more immediate concerns, including addressing the challenges posed by the food and financial crises.

The Commission noted that the failure to act quickly to address the global economic downturn inevitably will increase its depth and duration and the eventual cost of restoring prosperity. With that in mind, it makes the following recommendations for immediate action, which focus particularly on the adverse impact of the global recession on developing countries and on the poor throughout the world.

1. It is imperative that all the developed countries take strong and effective actions to stimulate their economies. In doing so, they should be mindful of the adverse consequences that their monetary and fiscal policy actions may have on other countries, especially developing countries. Additional assistance to developing countries may be required to offset these effects. An effective stimulus policy should be timely, have a large bang for the buck, help address the strains posed by the economic down turn on the poor, and to the extent possible, help address long run problems and prevent instability. Care should be taken to address potential negative impacts on global imbalances.

2. There are large asymmetries in global economic policies—countercyclical policies are pursued by developed countries, while most developing countries pursue pro-cyclical policies. But even symmetric policies can have asymmetric effects: guarantees provided to financial institutions in developed countries cannot be effectively matched by developing countries. Nor can they match in breadth and scale the subsidies being provided to financial and non-financial institutions in their bail-outs. Whether there ever was a level playing field may be debated; that there is no longer one cannot be. Even the knowledge that there may be a rescue if things go badly gives firms in advanced industrial countries a distinct advantage; they can undertake risks that those in poorer countries cannot. This highlights the lack of coherence between existing global macro and financial arrangements, policies, and frameworks and those governing trade.

3. It is imperative that developing countries be provided with funds to enable them to undertake comparable policies, to stimulate their economies, to provide social protection, and to ensure a flow of liquidity to their firms, including maintenance of trade credits. Failure to provide such support can have long term effects. There will be an increase in poverty and malnutrition and educations will be interrupted, with life long effects. The sense of global social solidarity will be impaired, making agreement on key global issues, such as responding to the challenges of climate change, more difficult. Developed countries should resist the temptation to cut back on development assistance. This is a time to expand assistance, probably by an order of magnitude of at least twenty per cent, including for infrastructure projects addressing long term development and environmental problems.

4. In some parts of the world, there are ample sources of liquid funds, and more of these need to be made available to the needy developing countries. However, countries with these funds are not now adequately represented in the multilateral institutions. While this highlights the need for long discussed reforms in their governance, in the short run the creation of a new credit facility, perhaps within the IMF, the World Bank, or regional or sub-regional development banks, should be considered. The new facilities should have their own governance, be more reflective of democratic principles, with stronger representation for developing countries. These new governance arrangements might serve as a model for future reforms of the multilateral institutions.

5. While funds within the International Financial Institutions are limited, it is imperative that more funds be provided, and that they be provided without the usual conditionalities, especially those that force these countries to pursue pro-cyclical policies or to adopt the kinds of monetary and regulatory policies which contributed to the current crisis. Besides the usual arguments against these conditionalities, they contribute to global asymmetries, disadvantaging developing countries relative to the developed, and they undermine incentives for developing countries to take up the funds, contributing to global economic weakness. While we commend the initial initiatives by the IMF, it is questionable whether they are sufficient.

6. Additional funding could be provided by a large issuance of Special Drawing Rights. The Commission, in later meetings, will address alternative modalities by which this may be done and assess longer term reforms in the global reserve system.

7. The Commission noted several regional efforts at cooperative responses to the crisis, including providing needed liquidity, and urged the consideration of their expansion. For instance, extension of liquidity support under the Chiang Mai initiative without an IMF program requirement should be given immediate consideration.

8. The crisis is widely viewed to be the result of the failure of regulatory policies in the United States and some other advanced industrial countries. To make significant and meaningful changes, it may be necessary to draw lessons from countries in the developed and developing world that have avoided instability.

9. The crisis highlights how policies and institutions in developed countries can have global systemically significant effects. Developing countries should have expanded scope for establishing policies and institutions appropriate for their conditions. This includes developing frameworks that help insulate themselves from regulatory and macro-economic failures in systemically significant countries.

10. Members of the Commission noted that while lack of transparency is widely recognized as having contributed to the problems in the financial market, there have been significant lapses in transparency in the manner in which the bail-outs have been conducted. The Commission urged greater transparency on the part of all parties in responding to the crisis.

11. While a successful completion of the Doha trade round would be welcome, certain actions could be implemented immediately, namely the opening of markets in advanced economies to least developed countries' exports.

The Commission will continue its work on reforms in regulatory and macro economic policies and in the international economic institutions and arrangements which will enhance global economic and financial stability and prosperity. Its next plenary meeting will be held in Geneva on March 8-10.

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

28 January 2009

Excellency,

You will kindly recall that the General Assembly, in its resolution 63/239 adopted on 24 December 2008, has endorsed the Doha Declaration, which stated that the United Nations will hold a conference on the world financial and economic crisis and its impact on development. The Declaration further stated that the conference will be organized by the President of the General Assembly and the modalities will be defined by March 2009 at the latest.

In this connection, I have the honour to attach herewith a draft resolution containing the proposed organization of the conference. For your reference and information, also attached is a schedule of related meetings between January and September 2009 that will help in the preparatory process for the conference and its outcome.

It is my intention to hold as early as possible in February an informal consultation of the plenary on the draft resolution to hear your views.

I have asked Mr. Michael Clark, Senior Adviser on my staff, to be available to any group, geographic or political, that desires to have an informational briefing on the proposed modalities.

In view of the worsening world financial situation and its impact on the real economy everywhere, I look forward to working closely with you to give a strong signal on the important role the General Assembly can play to address some of the critical challenges raised by the crisis.

Please accept, Excellency, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

All Permanent Representatives
and Permanent Observers
to the United Nations

Draft resolution A/63/L.XXX
By the President of the General Assembly

Organization of the Conference on the Global Financial and Economic Crisis and Its Impacts on Development

The General Assembly,

Recalling the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha, Qatar from 29 November to 2 December 2008, and the resulting Doha Declaration of 2 December 2008, as well as its resolution 63/239, through which it endorsed the Doha Declaration, which stated that the United Nations will hold a conference at the highest level on the world financial and economic crisis and its impact on development and that the conference will be organized by the President of the General Assembly with the modalities to be defined by March 2009 at the latest,

Concerned that the Millennium Development Goals and other international commitments adopted at UN international conferences may not be met by their respective target dates, and may be fundamentally compromised, if the current crisis is not overcome through timely and effective action,

1. *Decides* that the Conference on the Global Financial and Economic Crisis and Its Impacts on Development:

(a) Will be convened from 26 to 29 May 2009, at the United Nations Headquarters in New York;

(b) Will include participation of Member States of the General Assembly and observers, in accordance with the established practice of the General Assembly,

(c) Will be held at the highest possible political level, including with the participation of Heads of State and Government, ministers, special representatives and other representatives, as appropriate;

(d) Will be chaired by the President of the General Assembly;

(e) Will consist of:

(i) A short opening meeting on 26 May, with statements by the President of the Conference and the Secretary-General;

(ii) Four interactive multi-stakeholder round tables on 26 and 27 May, based on the major issues relating to the financial and economic crisis and its impacts on development;

(iii) A high-level segment on 28 and 29 May, consisting of plenary meetings at the level of Head of State and Head of Government or their designated representatives at ministerial and above level;

(iv) Negotiating and drafting sessions at the ministerial or highest possible level on 26 and 27 May and thereafter during the Conference, as necessary;

(f) Will result in an intergovernmentally agreed outcome document;

(g) Will also result in summaries of the plenary meetings and of the round-table discussions, to be included in the report of the Conference;

2. *Invites* funds, programmes and specialized agencies of the United Nations system, as well as non-governmental organizations, civil society and business sector entities accredited to the Doha Conference to participate in the preparatory process, and the Conference at United Nations, in accordance with the rules of procedure of the General Assembly;

3. *Requests* the President of the General Assembly to provide, in a timely manner, an information note on other organizational matters of the Conference;

4. *Invites* the Economic and Social Council to schedule at the time of its 27 April 2009 spring meeting with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development, a session devoted to comprehensive discussion of the global financial and economic crisis and its impact on development and provide recommendations for consideration in the preparatory process of the Conference;

5. *Calls upon* the regional commissions, with the support of regional financial institutions and other relevant entities, to hold regional consultations, as early as possible and to provide inputs to the preparations for the Conference;

6. *Requests* the funds, programs and specialized agencies of the United Nations system, including the Bretton Woods Institutions, to provide technical inputs within their areas of expertise and experience to serve as inputs for the preparatory process of the Conference, as early as possible;

7. *Invites* the Inter-Parliamentary Union (IPU) to take part in the Conference and its preparatory process, and encourages Member States to include in their national delegations Members of Parliament and welcomes the decision of the

IPU to organize an International Conference of Parliamentarians on the International Financial and Economic Crisis and its Impact on Development to provide inputs for the United Nations Conference;

8. *Welcomes* the initiative of the President of the General Assembly to open a Conference website that allows interested organizations and the public at large to register their opinions and recommendations as part of the preparatory process of the Conference;

9. *Welcomes also* the initiative of the President of the General Assembly to organize a thematic interactive dialogue to be held from 25 to 27 March, 2009, on the global financial and economic crisis and its impact on development;

10. *Requests* the President of the General Assembly to present the first draft outcome document by 6 April 2009, based upon all the preparatory inputs, reports and informal consultations listed above, to be followed by intergovernmental negotiations and drafting sessions starting from 13 April;

11. *Requests* the Secretary-General to provide all necessary assistance to the preparatory process and the Conference, including the launching of a global public awareness campaign.

CONFERENCE AT THE HIGHEST LEVEL ON THE WORLD FINANCIAL AND ECONOMIC CRISIS AND ITS IMPACTS ON DEVELOPMENT

Schedule of related meetings, January–September, 2009

January

- 5 and 6 January. First Plenary Meeting of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System and issues statement

- 28 January, UN headquarters in New York. Distribution of draft resolution on modalities to Member States

- Outreach to UN agencies and programs, UN Regional Commissions and other specialized agencies, including the IBRD, IMF, and WTO

- UN regional commissions will be invited by the PGA to organize consultations with Governments and other interested actors at the regional level, including regional financial institutions, to provide their perspective and contributions to the process

February

- First or second week of February: Informal plenary on modalities

- 9 to 11 February, Kuala Lumpur, Malaysia. Commission holds working group meeting

- February/March (TBC) (Berlin). Commission holds working group meeting. Commission also holds informal meeting with G-20 technical experts

- Facilitator to be appointed for the intergovernmental process of negotiations

- Outreach and consultations to NGOs and other civil society representatives, including private sector

March

- 9 to 11 March, Geneva, Switzerland. Second Plenary Meeting of the Commission of Experts

- 25 to 27 March, UN headquarters in New York. The President of the General Assembly will present the recommendations of the Commission in an interactive thematic dialogue. Participants will include Member States, international financial institutions, UN agencies, civil society and private sector. The PGA will formally request the participants to submit in writing their recommendations, in addition to their oral comments

- 25 to 27 March, UN headquarters in New York. Third Plenary Meeting of the Commission and participation of the Commission in the Interactive Thematic event organized by the PGA

- Special consultations will be also organized with specialized international organizations of the UN system, such as the ILO, UNCTAD, the Bretton Woods institutions, and UN agencies

- Civil society organizations will be able to participate through recommendations in writing posted on the website of the International Conference

April

- 6 April, UN headquarters in New York. The President of the General Assembly will present the draft outcome document

- 13 April, UN headquarters in New York. Intergovernmental negotiations on the Outcome Document will commence

- 27 or 28 April, UN headquarters. ECOSOC sponsored Interactive Dialogue with UNCTAD, the International Monetary Fund, the World Bank and the World Trade Organization

May

- Mid May, UN headquarters in New York. Release of Final report of Commission of Experts

- 18 and 19 May, Doha, Qatar. Fourth Plenary Meeting of the Commission to discuss and present recommendations on contentious issues of the Intergovernmental Process of negotiations and to continue working its final report

- 26 to 29 May, UN Headquarters New York. The United Nations Conference at the Highest Level on the World Financial and economic crisis and Its Impacts on Development. A draft Final Document will be submitted by the President of the General Assembly for the consideration of the Heads of State and Government for approval at the final session

June – September

- Follow-up activities and implementation of agreements of the Conference

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

9 February 2009

Excellency,

I should like to invite you to an informal consultation of the plenary to be held on Thursday, 12 February 2009, from 3 to 6 p.m. in Conference Room 4, to discuss the draft resolution that was transmitted to Member States with my letter dated 28 January 2009 on the organization of the conference at the highest level on the world financial and economic crisis and its impact on development.

Please accept, Excellency, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

All Permanent Representatives
and Permanent Observers
to the United Nations
New York

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

18 February 2009

Excellency,

You will kindly recall that the General Assembly, in its resolution 63/239 adopted on 24 December 2008, has endorsed the Doha Declaration, which stated that the United Nations will hold a conference on the world financial and economic crisis and its impact on development. The Declaration further stated that the conference will be organized by the President of the General Assembly and that the modalities will be defined by March 2009 at the latest.

To begin the preparatory process, on 28 January of this year I circulated to all Permanent Representatives a draft resolution on modalities, and on last Thursday, 12 February, I convened an informal plenary meeting of the General Assembly to review the proposed modalities.

I am pleased that all speakers during our informal plenary declared that they found the initial draft of the resolution on modalities a good basis for further discussions.

I am even more gratified that during our informal session all Members and delegations who spoke recognized the deepening global crisis and the critical role that the UN can play in addressing it, and that all highlighted their intention to cooperate fully in the conference and its preparatory process.

I now have the honor to present a revised proposal ("Rev 1") for a General Assembly resolution on modalities for the United Nations Conference on the World Financial and Economic Crisis and Its Impact on Development.

As I stated in my introductory remarks last Thursday, it is my hope that we can proceed with a sense of urgency and arrive at consensus on core procedural matters as soon as possible, for three basic reasons:

"1. So that the Secretary-General and I can approach world leaders with a firm decision in hand that there will be a conference at a date certain, and that it will produce a practical result.

All Permanent Representatives
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to the United Nations

2. So that world leaders can have the time required to begin the preparation process, especially the inter-ministerial consultation processes required for well-planned participation;

3. To be candid, so that the Secretariat and the staff can assign appropriate resources on the basis of a General Assembly resolution."

In my judgment, the revised proposal takes a reasonable approach to resolving most major issues raised by speakers last Thursday.

At the same time, many comments pointed to important considerations that are not dealt with directly in this revised draft resolution, but which could benefit from further discussion among the Members. In my judgment, most of these issues relate to details of the conference preparation and organization, and can be best addressed through technical level discussions that may be held to review and develop the work plan for the conference.

To assure, however, that all Member States have an opportunity to participate fully in the development of the international conference and its preparatory activities through an open and transparent process, I have appointed as facilitator H.E. Mr. Kaire Munionganda Mbuende, Permanent Representative of the Republic of Namibia and Vice-President of the General Assembly, to lead the process of consultation and to organize formal consideration of the revised modalities resolution at a date to be determined by him.

I place my trust in the Members of the General Assembly and in Ambassador Mbuende, and I count on your continued good faith and solidarity as we work together to find resources necessary to protect the most vulnerable people on our planet from the ravages of the global crisis.

Please accept, Excellency, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

Draft resolution A/63/L.XXX

By the President of the General Assembly

Organization of the United Nations Conference at the highest level on the World Financial and Economic Crisis and Its Impact on Development

The General Assembly,

Recalling the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha, Qatar from 29 November to 2 December 2008, and the resulting Doha Declaration of 2 December 2008, as well as its resolution 63/239, through which it endorsed the Doha Declaration, which stated that the United Nations will hold a conference at the highest level on the world financial and economic crisis and its impact on development and that the conference will be organized by the President of the General Assembly with the modalities to be defined by March 2009 at the latest,

Concerned that the Millennium Development Goals, and other international commitments adopted at UN international conferences may not be met by their respective target dates, and may be fundamentally compromised, if the current crisis is not overcome through timely and effective action,

1. *Decides* that the Conference on the Global Financial and Economic Crisis and Its Impact on Development:

(a) Will be convened from 1 to 4 June 2009, at the United Nations Headquarters in New York,

(b) Will include participation of Member States of the General Assembly and Observers, in accordance with the established practice of the General Assembly,

(c) Will be chaired by the President of the General Assembly;

(d) Will consist of:

(i) A short opening session on 1 June, with statements by the President of the Conference and the Secretary-General;

(ii) Four interactive multi-stakeholder high level round tables on 1 and 2 June, based on the major issues relating to the world financial and economic crisis and its impact on development, plenary meetings and, as needed, drafting and negotiating sessions,

(iii) A highest-level segment on 3 and 4 June, consisting of plenary meetings;

(e) Will result in an intergovernmentally agreed outcome document,

(f) Will also result in summaries of the plenary meetings and of the round-table discussions, to be included in the report of the Conference;

2. *Invites* funds, programmes and specialized agencies of the United Nations system, to participate in the Conference, in accordance with the rules of procedure of the General Assembly, and also to participate in the preparatory process of the conference by providing technical inputs within their mandates and areas of expertise and experience, by no later than 20 March;

2bis. Also invites other major institutional stakeholders including the Bretton Woods Institutions and the World Trade Organization, to participate in the Conference, in accordance with the rules of procedure of the General Assembly, and also to participate in the preparatory process of the conference by providing technical inputs within their mandates and areas of expertise and experience, by no later than 20 March;

2ter. Invites non-governmental organizations, civil society and business sector entities accredited to the Doha Conference to participate in the conference, in accordance with the rules of procedure of the General Assembly and to provide their inputs to the preparatory process of the conference, by no later than 20 March, and decides that;

(*a*) Registration will be open to all non-governmental organizations that are in consultative status with the Economic and Social Council and to all non-governmental organizations and business sector entities accredited to the Doha Conference;

(*b*) Interested non-governmental organizations and business sector entities that are not in consultative status with the Economic and Social Council or were not accredited to the Doha Conference shall apply to the General Assembly for accreditation following the accreditation procedures established during the Conference;

(*c*) The above arrangements concerning participation of non-governmental organizations and business sector entities in the Conference and its preparatory process will in no way create a precedent for meetings of the General Assembly;

3. *Requests* the President of the General Assembly to provide, in a timely manner, an information note on other organizational matters of the Conference;

4. *Invites* the Economic and Social Council to provide recommendations for consideration in the preparatory process of the Conference by no later than 20 March, and encourages the ECOSOC to take the opportunity to discuss the financial and economic crisis and its impact on development at its Spring meeting with the Bretton Woods Institutions, the World Trade Organization and the United Nations Conference on Trade and Development;

5. *Calls upon* the regional commissions, with the support of regional financial institutions and other relevant entities, to hold regional consultations, as early as possible and to provide inputs to the preparations for the Conference by no later than 20 March;

5.bis Requests the Secretary-General to prepare a report, based upon the analytical work of UN programmes, departments, and agencies, on the origins and causes of the present crisis, mechanisms of transmission to the developing countries, and on the potential impact of the crisis on development by no later than 20 March,

6. *Welcomes also* the initiative of the President of the General Assembly to organize a thematic interactive dialogue to be held from 25 to 27 March, 2009, on the global financial and economic crisis and its impact on development;

7. *Requests* the President of the General Assembly to present the first draft outcome document by 6 April 2009, based upon all the preparatory inputs, reports and informal consultations listed above, to be followed by intergovernmental negotiations and drafting sessions starting from 13 April;

8. *Requests* the Secretary-General to provide all necessary assistance to the preparatory process and the Conference, including the launching of a global public awareness campaign.

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

17 March 2009

Excellency,

I have the honour to inform you that from 25 to 27 March 2009, the General Assembly will conduct an extraordinary interactive thematic dialogue on the subject of The World Financial and Economic Crisis and Its Impact on Development.

The dialogue is intended to give Member States an overview of the broad range of issues involved as the world works to define a common plan of action for taking stock of the impact of the crisis, evaluating and choosing from among alternative short-term emergency measures, and defining an effective approach to longer-term issues in order to restore dynamism, revive employment, and enhance equity in our world economy.

As indicated, the dialogue will take place over three days, with each day devoted to a different set of topics and issues:

> Day 1, Wednesday, 25 March: will be devoted to a comprehensive review of the scale and scope of the crisis, its mechanisms of transmission, and range of impacts on nations and on society, with a focus on the impact and risks for the poor and vulnerable. For this assessment, we will rely principally upon programs and agencies of the United Nations system, including the analysis of the Department of Social and Economic Affairs (DESA), the United Nations Conference on Trade and Development (UNCTAD), the International Labor Organization (ILO), and the regional commissions.

For our discussions on Days 2 and 3, we will draw upon the analysis and proposals developed by the Commission of Experts that I have convened under the Chairmanship of Professor Joseph Stiglitz. The Commission's preliminary report will be made available no later than Friday, 20 March.

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to the United Nations

Day 2, Thursday, 26 March
Morning: the Chairman of the Commission of Experts, Professor Joseph Stiglitz, will present the principal recommendations of the commission as well as the analysis and perspective that lie behind them during the morning session.
Afternoon: we will take a deeper look at key macroeconomic policy issues. Again, we will focus particularly on the needs of those who are most vulnerable, especially peoples whose governments do not have the resources or mechanisms to support counter-cyclical policies and for whom access to credit and investment has been severely impaired. We will also assess the impact of policies that have already been adopted to date to restore demand, promote employment, and restore equity and growth.

Day 3: Friday, 27 March: The crisis has revealed the depth of world-wide economic interdependence, and also exposed numerous weaknesses and gaps in the institutional and regulatory framework for managing our integrated global economy. This session will be devoted to examining the intermediate- and longer-term proposals for reducing systemic and individual risk, improving policy response and coordination, and enhancing legitimacy and equity in management of the global economic and financial system.

The interactive thematic dialogue is conceived as a curtain-raiser not only for the extensive preparatory process leading up to the United Nations conference at the highest level to be held in June 2009 but also as a means to provide information and analysis useful for coordination with other on-going processes related to the financial and economic crisis.

In the coming days I will provide additional details on this event. I look forward to your participation, and invite you to involve other representatives of your Government whose participation you deem important.

I hope this process will help Members States to work together to develop a common understanding of the crisis, and to explore alternative proposals for coordinated action and for beginning a process of systemic reform.

Please accept, Excellency, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

20 March 2009

Excellency,

With reference to the letter dated 17 March 2009 from the President of the General Assembly, H.E. Miguel d'Escoto Brockmann, please find attached the draft programme of the extraordinary interactive thematic dialogue to be held by the General Assembly from 25 to 27 March 2009, on the subject of "The World Financial and Economic Crisis and Its Impact on Development".

Please accept, Excellency, the assurances of my highest consideration.

Norma Miranda
Ambassador
Chef de Cabinet

All Permanent Representatives
and Permanent Observers
to the United Nations
New York

Interactive Thematic Dialogue

On the Financial and Economic Crisis and its Impact on Development

25 – 27 March 2008

United Nations Headquarters, New York

(Provisional)

Programme

<u>25 March (Analysis of the crisis)</u>

10:00 a.m. Opening statement by the President of the General Assembly

Morning Panel - The crisis: origins, evolution, and systemic aspects
Moderator: H. E. Morten Wetland, Permanent Representative of Norway to the United Nations.

10:20 a.m. 11:20 a.m.
Presentation 1: Mr. Jomo Kwame Sundaram, Assistant Secretary-General. DESA.
Presentation 2: Ms. Jane Stewart, Special Representative to the United Nations. International Labor Organization (ILO).
Presentation 3: Ms. Alicia Barcena, Executive Secretary ECLAC. Regional dimensions of the crisis. Videoconference.

11:20 a.m. – 11:40 p.m.
Comments by:
- Mr. Andrey Denisov, First Deputy Foreign Minister of the Russian Federation.
- Prof. Mario Baldassarri, Senator, Chairman of the Committee on Finance and Treasury of the Italian Senate.

11:40 a.m. – 1 p.m.
Questions and answers and statements by Member States, groups of states, international organizations and other organs of the UN system. Two questions or statements by two representatives of civil society organizations.

Afternoon Panel: UN System Responses to the crisis
Moderator: Mr. Yu Yongding. Director, Institute of World Economics and Politics, Chinese Academy of Social Sciences. Former Member of Monetary Policy Committee, People's Bank of China. Member of the Commission of Experts of the PGA.

3:00 – 4:15 p.m.
Presentation 1: Mr. Ugo Panizza. Chief of the Debt and Financial Analysis Unit, Debt and Development Finance Branch, Division on Globalization and Development Strategies, United Nations Conference on Trade and Development (UNCTAD).
Presentation 2: Mr Selim Jahan, Director, Poverty Group, Bureau for Development Policy, United Nations Development Programme (UNDP).
Presentation 3: Mr. Jeffrey Lewis, Senior Advisor, World Bank.
Presentation 4: Mr. Ranjit Teja, Deputy Director of Strategy Policy and Review Department, International Monetary Fund.

Comments by: Mr. Martin Khor, Executive Director of the South Centre.

4:15 - 6:00 p.m. Questions and answers and statements by Member States and groups of states, international organizations and other organs of the UN system. Two questions or statements by two representatives of civil society organizations.

26 March
Morning Presentation.
Moderator: H.E. In Kook Park, Permanent Representative of the Republic of Korea to the United Nations.

10:00 – 11.00 a.m.
Introduction of the Recommendations. *Professor Joseph Stiglitz* (USA), Chairman of the Commission of Experts accompanied by Members of the Commission.

11.00 a.m.-1.00 p.m. Questions and answers and statements by Member States and groups of states and UN agencies. Two questions or statements by two representatives of civil society organizations.

Afternoon Panel.
Moderator: H.E. Mrs. U. Joy Ogwu, Permanent Representative of Nigeria to the United Nations.

3:00 – 3. 45 p.m.
Panel 1: Reform of International Institutions
Ms. Heidemarie Wieczorek-Zeul (Germany)
Mr. Jomo K.S. (United Nations)
Mr. François Houtart (Belgium)
Mr. Pedro Páez (Ecuador)

3:45 – 4:30 p.m.
Panel 2: Macroeconomic measures in response to the Crisis:
Mr. Jean-Paul Fitoussi, Chair (France)
Mr. Jomo K.S. (United Nations)
Mr. Robert Johnson (USA)
Mr. Yaga Venugopal Reddy (India)

Comments by: Mr. Jon S. Corzine, Governor of the State of New Jersey, USA (To be confirmed)

4:30 – 6:00 p.m.
Questions and answers and statements by Member States and groups and UN agencies. Two questions or statements by two representatives of civil society organizations.

27 March

Morning Panel.
Moderator: H. E. Claude Heller, Permanent Representative of Mexico to the United Nations.

10:00 – 10:30 a.m.
Panel 3: International Financial Architecture:
Mr. Yu Yongding, Chair (China)
Mr. Yaga Venugopal Reddy (India)
Mr. Benno Ndulo (Tanzania)
Ms. Heidemarie Wieczorek-Zeu (Germany)
Ms. Zeti Akhtar Aziz (Malaysia)

10:30 - 11.00 a.m.
Panel 4: Re-Regulating the Financial System
Mr. Robert Johnson, Chair (USA)
Mr. Yaga Venugopal Reddy (India)
Mr. Benno Ndulo (Tanzania)

11:00 p.m. – 12:45 p.m.
Questions and answers and statements by Member States and groups and UN agencies. Two questions or statements by two representatives of civil society organizations.

Closing
12:45 p.m.
Final remarks. *Professor Joseph Stiglitz*, Chairman of the Commission of Experts.

THE PRESIDENT
OF THE
GENERAL ASSEMBLY

20 March 2009

Excellency,

Further to my letter dated 17 March 2009 informing you of the extraordinary interactive dialogue on the subject of The World Financial and Economic Crisis and its Impact on Development, I have the pleasure to transmit for your consideration the draft recommendations of the Commission of Experts of the President of the General Assembly on Reforms of the International Monetary and Financial System.

As mentioned in my previous letter, these recommendations and the analysis that underlies them will figure prominently in the interactive thematic dialogue on "The World Financial and Economic Crisis and its Impact on Development", that will take place from 25 to 27 March 2009 at United Nations Headquarters in New York.

It is my hope that Members of the General Assembly will find these recommendations, and the dialogue next week, useful as they prepare for the United Nations Conference on World Economic and Financial Crisis and Its Impact on Development, which will be convened in little more than two months time in accordance with General Assembly resolution 63/239 of 24 December 2008.

Please accept, Excellency, the assurances of my highest consideration.

Miguel d'Escoto Brockmann

All Permanent Representatives
and Permanent Observers
to the United Nations

DRAFT

A/63/XXX

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19 March 2009

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Sixty-third sessions
Agenda item 48
Follow-up to and implementation of the outcome of the 2002 International Conference on Financing for Development and the preparation of the 2008 Review Conference

Recommendations by the Commission of Experts of the President of the General Assembly on reforms of the international monetary and financial system

Note by the President of the General Assembly

1. The outbreak of the financial crisis in 2008 originated in the advanced developed countries, but has spread quickly to become a world economic crisis that affects all countries, including the emerging economies and less developed countries.

2. To review the workings of the global financial systems and to explore ways and means to secure a more sustainable and just global economic order, I have convened a Commission of Experts, chaired by Professor Joseph Stiglitz, 2001 Nobel laureate Prize winner in Economics, and comprised of a outstanding economists, policy makers, and practitioners drawn from Japan, Western Europe, Africa, Latin America, South and East Asia. These experts were chosen based on their comprehensive understanding of the complex and interrelated issues raised by the workings of the financial system. The Commissioners are also individuals recognized for their strong grasp of the strengths and weaknesses of existing multilateral institutions as well as their sensitivity to the particular challenges facing countries from different regions of the world and at different levels of economic and social development.

3. I now have the pleasure to transmit the preliminary recommendations of the Commission for your consideration. These recommendations and the analysis that underlies them will figure prominently in the interactive thematic dialogue on "The World Financial and Economic Crisis and its Impact on Development", which I will convene from 25 to 27 March 2009 at United Nations Headquarters in New York. It is my hope that Members of the General Assembly will find these recommendations, and the dialogue next week, useful as they prepare for the United Nations Conference on World Economic and Financial Crisis and Its Impact on Development, which will be convened in little more than two months time in accordance with General Assembly resolution 63/239 of 24 December 2008.

THE COMMISSION OF EXPERTS ON REFORMS OF THE INTERNATIONAL MONETARY AND FINANCIAL SYSTEM

Recommendations
19 March 2009

I. Preamble

1. The rapid spread of financial crisis from a small number of developed countries to engulf the global economy provides tangible evidence that the international trade and financial system needs to be profoundly reformed to meet the needs and changed conditions of the 21st century. Past economic crises have had a disproportionate adverse impact on the poor, who are least able to bear these costs and that can have consequences long after the crisis is over.

2. While it is important to deal with the structural changes to adapt the international system to prevent future crisis, this cannot be achieved without significant measures to promote recovery from the current crisis whose impact may be even worse than in the past. The International Labour Organization estimates that the rise in unemployment in 2009 compared to 2007 of 30 million could reach more than 50 million if conditions continue to deteriorate. Some 200 million people, mostly in developing economies, could be pushed into poverty if rapid action is not taken to counter the impact of the crisis on developing countries. Even in some advanced industrial countries, millions of households are faced with the threat of losing their homes and access to health care, while economic insecurity and anxiety is increasing among the elderly as they lose their life-time savings in the collapse of asset prices.

3. The welfare of developed and developing countries is mutually interdependent in an increasingly integrated world economy. *Short term measures to stabilize the current situation must ensure the protection of the world's poor, while long term measures to make another recurrence less likely must ensure sustainable financing to strengthen the policy response of developing countries.* Without a truly inclusive response, recognizing the importance of all countries in the reform process, global economic stability cannot be restored, and economic growth, as well as poverty reduction worldwide will be threatened.

4. This inclusive global response will require the participation of the entire international community; it must encompass more than the G-7 or G-8 or G-20, but the representatives of the entire planet, from the G-192. It was to respond to this need that the President of the General Assembly created the present Commission of Experts to address the measures needed to meet the crisis and recommend longer term reforms. Recognising work being undertaken by the G-8 and the G-20, and other

bodies, the Commission sees its own work as complementary, seeking to focus on impacts of the crisis and responses to the crisis on poverty and development.

5. Reform of the International system must have as its goal the better functioning of the world economic system for the global good. This entails simultaneously pursuing long term objectives, such as sustainable and equitable growth, the creation of employment in accordance with the “decent work” concept, the responsible use of natural resources, and reduction of greenhouse gas emissions, and more immediate concerns, including addressing the challenges posed by the food and financial crises. As the world focuses on the exigencies of the moment the long standing commitments to the achievement of the Millennium Development Goals and protecting the world against the threat of climate change must remain the overarching priorities; indeed, appropriately designed global reform should provide an opportunity to accelerate progress toward meeting these goals.

II. Responding to the Global Financial Crisis

6. Sustainable responses to the crisis require identifying the factors underlying the crisis and its rapid spread around the world. Loose monetary policy, inadequate regulation and lax supervision interacted to create financial instability. The results were manifest in the large global imbalances whose disorderly unwinding in the absence of prompt countercyclical measures may aggravate the crisis.

7. Part of the reason for inadequate regulation was an inadequate appreciation of the limits of markets—what economists call “market failures.” While such failures arise in many markets, they are particularly important in financial markets and can have disproportionately large consequences as they spill over into “real” economic activity.

8. The conduct of monetary policy can be traced in part to an attempt to offset an insufficiency of global aggregate demand, aggravated by increasing income inequality within most countries. Monetary conditions were also influenced by the accumulation of foreign exchange reserves by some emerging market countries seeking protection from global instability and onerous conditions traditionally attached to assistance from the multilateral financial institutions.

9. The current crisis reflects problems that go beyond the conduct of monetary policy and regulation of the financial sector. It also involves deeper inadequacies in areas such as corporate governance and competition policies. Many of these failings, in turn, have been supported by a flawed understanding of the functioning of markets, which also contributed to the recent drive towards financial deregulation. These views have been the basis for the design of policies advocated by some of the international economic institutions, and for much of the architecture of globalization.

10. More generally, the current crisis has exposed deficiencies in the policies of some national authorities and international institutions based on previously fashionable economic doctrines, which held that unfettered markets are, on their own, quickly self-correcting and efficient. Globalization too was constructed on these flawed hypotheses; and while it has brought benefits to many, it has also enabled defects in one economic system to spread quickly around the world, bringing recessions and impoverization even to developing countries that have developed good regulatory frameworks, created effective monetary institutions, and succeeded in implementing sound fiscal policies.

11. The Principles and Recommendations outlined in this Report seek to address the underlying problems. They focus both on feasible interim steps that can and should be taken immediately, and the deeper medium and longer term reforms that are necessary if we are to make another such crises less likely, and if we are to strengthen the international community's capacity to respond to a crisis, should one occur.

12. In analyzing appropriate national and global responses to the crisis, the Commission noted the following principles:

13. Failure to act quickly to address the global economic downturn inevitably would increase its depth and duration and the eventual cost of creating a more balanced robust recovery.

14. In a globally integrated world, the actions of any one country have effects on others. Too often these *externalities* are not taken into account in national policy decisions. Developed countries in particular need to be aware of the adverse consequences of these externalities, and developing countries need frameworks to help protect themselves from regulatory and macro-economic failures in systemically significant countries.

15. Developing countries should have expanded scope to implement policies and create institutions that will allow them to implement appropriate counter-cyclical policies.

16. Advanced industrial countries should observe their pledges not to undertake *protectionist* actions, and even more importantly insure that stimulus packages and recovery programs do not further distort the economic playing field and further increase global imbalances.

17. Measures to restore domestic financial markets in developed countries through *subsidies* to financial institutions have been accompanied by a sharp reduction in flows of capital to developing countries. It is important to ensure that these measures do not create a new form of financial protectionism. Financial subsidies can be just as detrimental to the efficiency of a free and fair trading system as tariffs. Indeed, they

may be far more inequitable, because rich countries have more resources to support subsidies.

18. Greater transparency on the part of all parties in responding to the crisis is necessary. More generally, democratic principles, including inclusive participation in decision making, should be strengthened and respected.

19. The crisis is, in part, a result of excesses in deregulation of financial markets and in international trade. Restoring the global economy to health will require restoring a balance between the role of the market and the role of the state.

20. In responding to this crisis, it is imperative that actions to improve conditions in the short term do not result in structural changes which increase instability or reduce growth in future.

21. It is essential that governments undertake reforms that address some of the underlying factors that contributed to the current economic crisis if the world is to emerge from the crisis into sustainable, balanced growth. It is not enough simply to return to the status quo *ex ante.*

22. Appropriately designed short run measures may be complementary to long term goals, especially those related to climate change and the environment.

III. Immediate Measures

23. The current crisis must be met with rapid and effective measures, but it must also lay the basis for the long-run reforms that will be necessary if we are to have a more stable and more prosperous global economy and avoid future global crises.

24. Ten immediate measures are essential for global recovery.

1. All developed countries should take strong, coordinated, and effective actions to stimulate their economies.

25. Stimulus should be timely, have large "multipliers," help address the strains posed by the economic downturn on the poor, help address long run problems and prevent instability. While the decision on stimulus is national, it should be judged on its *global impacts;* if each country looks only at the national benefits versus costs, e.g. an increased national debt, the size of the global stimulus will be too small, spending will be distorted, and the global impact will be eviscerated.

26. *National stimulus packages should thus include spending measures to be undertaken in developing countries to offset the impact of the decline in world trade and financial market disintermediation. Industrialised countries should thus dedicate 1.0 per cent*

of their stimulus packages, in addition to traditional official development assistance commitments.

2. **Developing countries need additional funding**

27. More permanent and stable sources of funding for developing countries (See Section IV.10 below) that could be activated quickly and are not subject to inappropriate conditionality are necessary. Indeed, additional funding would be required just to offset the imbalances and inequities created by the massive stimulus and bail-out measures introduced in advanced industrialised countries. Such funding could be provided by an issuance of Special Drawing Rights approved by the IMF Board in September 1997 through the proposed Fourth Amendment of the Articles of Agreement to double cumulative SDR allocations to SDR 42.8 billion and through the issuance of additional SDRs through standard procedures.

28. In addition regional efforts to augment liquidity should be supported. For instance, extension of liquidity support under the Chiang Mai initiative without an IMF program requirement should be given immediate consideration. Regional cooperation arrangements can be particularly effective because of a greater recognition of cross-border externalities and greater sensitivities to the distinctive conditions in neighbouring countries.

29. These additional sources of funding should be in addition to traditional official development assistance. Failure to maintain the levels of official assistance will have long-term effects. There will be an increase in poverty and malnutrition and the education of many young people will be interrupted, with life-long effects. The sense of global social solidarity will be impaired, making agreement on key global issues, such as responding to the challenges of climate change, more difficult. Failure to provide such assistance can be counterproductive even in a more narrow sense: it can impair the global recovery.

30. *Developed countries must make a renewed effort to meet the commitments made in the Millennium Declaration, the Monterrey Consensus, the 2005 Global Summit, and the Doha Declaration by 2015.*

3. **Mobilizing Additional Development Funds by the Creation of a New Credit Facility**

31. The creation of a new credit facility is thus a matter of urgency. If such a facility could be created in a timely way, it could be a major vehicle for the disbursement of the requisite additional funding.

32. Given the need for rapid response, the new credit facility might be more quickly established under the umbrella of existing institutions, such as the World Bank, where

efforts are underway to remedy existing inadequacies in governance and lending practices, or in Regional Development Banks where developing countries have more equitable representation.

33. Or alternative institutional arrangements that create competition amongst institutions providing financial assistance might be envisaged. Such competition might not only increase the efficiency of disbursement, but also reduce the application of procyclical conditionality linked to financial support.

34. Whatever form is chosen, the new facility should have governance more reflective of democratic principles, with strong representation of developing countries and those countries contributing to the facility. These new governance arrangements might provide lessons for the reform of existing institutions.

35. Administration of the Facility could be done by staff seconded from existing multilateral financial institutions or central banks. The new facility could draw upon financial contributions from all countries. It could leverage any equity funds contributed by borrowing, including on the market or from those with large reserves or Sovereign Wealth Funds. Its ability to borrow could be enhanced through guarantees provided by governments, especially those of the advanced industrial countries. These alternative arrangements should be seen as a complement to expanded financial support from existing institutions,

4. Developing Countries need more policy space

36. There are asymmetries in global economic policies—countercyclical policies are pursued by developed countries, while most developing countries are encouraged or induced to pursue pro-cyclical policies. While this is partly due to the lack of resources to pursue countercyclical policies, it is also due to misguided policy recommendations from international financial institutions. Conditionality attached to official lending and support for international financial institutions has often required developing countries to adopt the kinds of monetary and regulatory policies which contributed to the current crisis. In addition, these conditionalities contribute to global asymmetries, disadvantage developing countries relative to the developed, and undermine incentives for developing countries to seek support funding, contributing to global economic weakness. While the IMF initiatives to reduce conditionalities are to be commended, they might be insufficient, while in many cases countries are still required to introduce pro-cyclical policies.

5. The lack of coherence between policies governing trade and finance must be rectified.

37. Policy space is circumscribed not only by a lack of resources, but also by international agreements and by the conditionalities that often accompany assistance.

Many bilateral and multilateral trade agreements contain commitments that circumscribe the ability of countries to respond to the current crisis with appropriate regulatory, structural, and macro-economic reforms and rescue packages, and may have exposed them unnecessarily to the contagion from the failures elsewhere in the global economic system. *Developing countries especially need policy frameworks that can help protect them from regulatory and macro-economic failures in systemically significant countries.* Developing countries have had imposed on them not only deregulation policies akin to those that are now recognized as having played a role in the onset of the crisis, but also have faced restrictions on their ability to manage their capital account and financial systems (e.g. as a result of financial and capital market liberalization policies); these policies are now exacting a heavy toll on many developing countries.

6. Crisis response must avoid protectionism

38. Overt protectionism includes tariffs and domestic restrictions on procurement contained in some stimulus packages. Because of complex provisions and coverage of international trade agreements, seemingly “symmetric” provisions (e.g. exceptions of the application of provisions to countries covered by particular WTO or other international agreements) can have markedly asymmetric effects. Subsidies, implicit and explicit, can, as has been noted, be just as distorting to open and fair trade. There may, in some cases, be pressure for banks receiving large amounts of government assistance to focus on lending domestically. While the temptation that gives rise to such measures is understandable, efforts need to be made to finance additional support to developing countries to mitigate the impact of the crisis as well as of both open and hidden subsidies (i.e. state assistance through lending programs and guarantees) in order to avoid further distortions.

7. Opening advanced country markets to least developed countries’ exports

39. While a successful completion of the Doha trade round would be welcome, its impact on the crisis and its development dimension are still unclear (see IV.9, below). There are, however, a number of measures that have already been agreed in multilateral trade negotiations which could be implemented rapidly to support developing countries impacted by the crisis. These include implementation of duty-free, quota-free market access for products originated from LDCs. In addition, the agreement reached at the WTO´s Hong Kong Ministerial session in 2005 provided for the elimination of all forms of developed country export subsidies, at the latest by 2013, should be implemented immediately. There is no reason to await a general agreement before implementing these measures. In addition, domestic support for cotton subsidies should be abolished immediately, as they distort prices to the detriment for African countries. More generally, in all trade negotiations, the long recognized principle of special and differential treatment of developing countries should be preserved.

8. Learning from Successful Policies to undertake Regulatory Reforms.

40. The financial crisis is widely viewed to be the result of the failure of regulatory policies in the advanced industrial countries. While full regulatory reforms (discussed more extensively in section IV.6 below) will take time, it is imperative that work on regulatory reform begin now. The collapse in confidence in the financial system is widely recognized as central in the economic crisis; restoration of confidence will be central in the recovery. But it will be hard to restore confidence without changing the incentives and constraints facing the financial sector. *It is imperative that the regulatory reforms be real and substantive, and go beyond the financial sector to address underlying problems in corporate governance and competition policy, and in tax structures, giving preferential treatment to capital gains, that may provide incentives for excessive leverage.* While greater transparency is important, much more is needed than improving the clarity of financial instruments. Even if there had been full disclosure of derivative positions, their complexity was so great as to make an evaluation of the balance sheet position of the financial institutions extraordinarily difficult. Still, there is need for much greater transparency, including forbidding off balance sheet transactions and full expensing of employee stock options.

41. Well regulated economies have to be protected from competition from economies with inadequate or inappropriate regulatory systems. The problems of regulatory arbitrage and tax evasion are closely linked. Tax havens and financial centers in both developed and developing countries *that fail to meet basic standards of transparency, information exchange and regulation should be given strong incentives to reform their practices*, e.g. by restricting transactions between financial institutions in those jurisdictions and those in more highly regulated countries. Institutional arrangements for improving harmonisation and transparency should be strengthened, including the United Nations Committee of Experts on International Cooperation in Tax Matters as proposed in Paragraph 16 of the Doha Declaration. Also other international arrangements and conventions such as United Nations Convention against Corruption should also be strengthened.

9. Coordinating the Domestic and Global Impact of Government Financial Sector Support

42. Government bail-outs have substantial redistributive consequences that must be analysed in assessing their impact on recovery. In addition, because of the urgency of the situation they often fail to observe principles of good governance and especially of democratic transparency. This may lead to the introduction of inappropriate incentives, as well as failure to recognise possible adverse effects on other countries, especially on developing countries that lack equivalent financial resources.

Developed countries should undertake their financial support policies recognising that even symmetric policies can have asymmetric effects because guarantees by developing country governments are likely to be less meaningful than those by developed countries.

43. Failure to recognise these wider domestic and global consequences of financial support measures have often meant that the costs to the government and to developing countries have been higher than necessary. Funds have often been redistributed to those with higher incomes, and have created distorted incentives. Support measures for financial institutions that are implemented by Central Banks risk imposing high costs on the public purse, without adequate parliamentary oversight of appropriations. *Greater transparency on the part of all parties would facilitate a more effective response to the crisis.*

10. Improved coordination of global economic policies

44. There is a need for substantial improvement in the coordination of global economic policy. Global economic integration has outpaced the development of the appropriate political institutions and arrangements for governance of the global economic system. Remedying this lacuna is a matter of urgency, discussed at greater length in section IV.3, but this will not happen overnight.

45. In the short term, there should be an appropriate mechanism within the United Nations System for independent international analysis on questions of global economic policy, including its social and environmental dimensions. Following the successful example of the Intergovernmental Panel on Climate Change (IPCC), a similar panel could be created to offer consultancy to the General Assembly and ECOSOC, but also to other international organizations to enhance their capacity for sound decision-making in these areas. At the same time, such a panel would contribute to foster a constructive dialogue and offer a regular venue for fruitful exchange between policy makers, the academic world and key international organisations. The panel should comprise well respected academics from all over the world, appropriately representing all continents, as well as representatives of international social movements. Being made up of outstanding specialists, the panel should be able to follow, analyse and assess long-term trends, key developments and major dynamics for global change affecting all people around the globe, identify problems in the global economic and financial architecture, and jointly provide options for coherent international action and recommendations for political decision-making processes.

IV. Agenda for Systemic Reforms

46. There is an equally important agenda of deeper systemic reforms to the international system, that should begin now, if we recovery is to be sustainable.

1. A New Global Reserve System

47. The global imbalances which played an important role in this crisis can only be addressed if there is a better way of dealing with international economic risks facing countries than the current system of accumulating international reserves. Indeed, the magnitude of this crisis and the inadequacy of international responses may motivate even further accumulations. Inappropriate responses by some international economic institutions in previous economic crises have contributed to the problem, making reforms of the kind described here all the more essential. To resolve this problem ***a new Global Reserve System—***what may be viewed as a greatly expanded SDR, with regular or cyclically adjusted emissions calibrated to the size of reserve accumulations—could contribute to global stability, economic strength, and global equity. Currently, poor countries are lending to the rich reserve countries at low interest rates. The dangers of a single-country reserve system have long been recognized, as the accumulation of debt undermines confidence and stability. But a two (or three) country reserve system, to which the world seems to be moving, may be equally unstable. The new Global Reserve System is feasible, non-inflationary, and could be easily implemented, including in ways which mitigate the difficulties caused by asymmetric adjustment between surplus and deficit countries.

2. Reforms of the Governance of the International Financial Institutions

48. There is a growing international consensus in support of reform of the governance, accountability, and transparency in the Bretton Woods Institutions and other non-representative institutions that have come to play a role in the global financial system, such as the Bank for International Settlements, its various Committees, and the Financial Stability Forum. These deficiencies have impaired the ability of these institutions to take adequate actions to prevent and respond to the crisis, and have meant that some of the policies and standards that they have adopted or recommended disadvantage developing countries and emerging market economies. Major reforms in the governance of these institutions, including those giving greater voice to developing countries and greater transparency are thus necessary.

49. The reform of the World Bank's governance structure should be completed swiftly. For the second stage of the reform, focussing on the realignment of shares, three criteria could be taken into account: economic weight, contribution to the development mandate of the World Bank (for example, measured in terms of contributions to IDA and trust funds), and the volume of borrowing from the Bank.

50. For the IMF, serious consideration should be given to restoration of the weight of basic votes and the introduction of double or multiple majority voting.

51. Elections of the leaders of the World Bank and the International Monetary Fund should take place under an open democratic process.

3. A Global Economic Coordination Council.

52. A globally representative forum to address areas of concern in the functioning of the global economic system in a comprehensive way must be created. At a level equivalent with the General Assembly and the Security Council, such a Global Economic Council should meet annually at the Heads of State and Government level to assess developments and provide leadership in economic, social and ecologic issues. It would promote development, secure consistency and coherence in the policy goals of the major international organisations and support consensus building among governments on efficient and effective solutions for issues of global economic, governance. Such a Council could also promote accountability of all international economic organizations, identify gaps that need to be filled to ensure the efficient operation of the global economic and financial system, and help set the agenda for global economic and financial reforms. It would be supported intellectually by the work of the International Panel discussed in III.10. Representation would be based on the constituency system, and designed to ensure that all continents and all major economies are represented. At the same time, its size should be guided by the fact that the council must remain small enough for effective discussion and decision making All important global institutions, such as the World Bank, IMF, WTO, ILO and members of the UN Secretariat dealing with economic and social issues would provide supporting information and participate in the Council. It could thus provide a democratically representative alternative to the G-20.

4. Better and more balanced surveillance.

53. The surveillance of economic policies should be especially focused on systemically significant countries, those whose bad performance is most likely to have global consequences. Such surveillance should focus not just on inflation, but on unemployment, financial stability, systemic stability related to the presence of built in stabilizers or destabilizers, and systems of social protection.

5. Reforming Central Bank Policies to promote Development

54. Whereas price stability is desirable in support of growth and financial stability, it is not sufficient. Central Banks should therefore aim to ensure price stability in the context of delivering long-term sustainable growth, while being sensitive to the risks to financial stability, capital flows and exchange rates. Central banks also need to give consideration to financial market and asset price developments. This may entail Central Banks using a wider range of instruments, including prudential instruments. A distinction may need to be made between the roles of Central Banks in maintaining financial stability under normal circumstances and during crisis periods. Central

Bank governance arrangements may need to differ depending on their precise role. In particular, in any actions which may impose serious risks on a country's fiscal position, such as those now being implemented in many countries as part of financial institution resolutions, should be subject to coordination.

6. Financial Market Policies

55. Financial policies, including regulation, have as their objective not only ensuring the safety and soundness of financial institutions and stability of the financial system, but protection of bank depositors, consumers and investors and ensuring financial inclusion - such as access to all banking services including credit, and the provision of financial products which help individuals and families manage the risks they face and gain access to credit at reasonable terms. It is also imperative to make sure that the sector is competitive and innovative.

56. Financial institutions have been allowed to grow to be too big to fail, imposing enormous risk on the global economy. And while there has been innovation, too much of the innovation was aimed at regulatory, tax, and accounting arbitrage, and too little at meeting the real needs of ordinary citizens. Too little was done to help developing countries and ordinary homeowners manage the risks which they face, with consequences that have been repeatedly apparent. Financial regulation must be designed so as to enhance meaningful innovation that improves risk management and capital allocation.

57. The current crisis has made it apparent that there are large gaps and deficiencies in the regulatory structures in place in many systemically significant countries. It is also apparent that while effective regulatory system must be national there must be some global regulatory framework to establish minimum national standards and also govern the global operations of systemical relevant global financial institutions. The Report of the Commission will identify a number of key aspects of regulatory reform, emphasizing the need for deep and pervasive reforms and highlighting the risks of merely cosmetic changes in regulations. The following items are among the key aspects of needed reform.

(a) Financial Product Safety

58. Sustainable recovery will depend on appropriate regulations (across countries, products, and institutions). Regulations should be based on what things are, not what they are called, i.e. insurance products should be regulated the same way, whether called insurance or not. Financial regulators should be mandated to ascertain the safety and appropriate use of various financial instruments and practices, including through the creation of a Financial Products Safety Commission.

59. Core depository institutions should be restricted from undertaking excessively risky activities and tightly regulated. There also needs to be close oversight over all highly levered and all systemically significant institutions. But there should be oversight over all financial institutions. Institutions can quickly change into systemically significant.

(*b) Comprehensive Application of Financial Regulation*

60. The fact that correlated behavior of a large number of institutions, each of which is not systemically significant, can give rise to systemic vulnerability makes oversight of all institutions necessary. There needs to be tighter regulation of incentives, especially in the core institutions; part of the current problem is a result of distorted incentives which encouraged short sighted and excessively risky behavior. It may be easier to regulate incentives than every manifestation of perverse incentives. There need to be restrictions on leverage, with automatic countercyclical capital adequacy and/or provisioning requirements.

61. Although the activities of private investment funds, equity funds and hedge funds did not trigger the financial crisis, their regulation is not globally uniform, creating the potential for regulatory arbitrage and the potential for gaps in regulation. Funds should be registered in the countries of their operations and provide appropriate regulation to regulatory authorities. In addition, banks must define limits for transactions with hedge funds.

62. There should be no retreat from mark to market accounting for institutions with short-term funding in order to provide full transparency for investors and regulators. Other institutions may be encouraged to supplement mark-to-market accounting with valuations that are more appropriate to the maturity of their liabilities. In addition, steps should be taken to enforce transparency norms and public accountability for all public companies.

(*c) Regulation of derivatives trading*

63. The large scale use of unregulated, unsupervised OTC derivatives has resulted in undue complexity, opacity, and mis-pricing of these instruments, and facilitated capital avoidance by financial institutions. These practices have weakened our financial system significantly and made resolution of failing firms extremely difficult.

64. Where appropriate steps should be take to develop regulated exchanges for trading standardized contracts of systemically significant derivative contracts, with the associated regulatory restrictions including limits on non-commercial traders. Regulations should insure that derivative instruments are held on balance sheets, valued at independently audited real transaction prices, with appropriate capital provisioning, and clarity of purpose. The use of over the counter contracts by core

institutions should, in general, be discouraged, but whenever used, there should be ample and adequate margin.

(d) Regulation of Credit Rating Agencies

65. Other needed reforms, including for Credit Rating Agencies and systems of information provision are addressed in an Appendix.

(e) Towards global institutional arrangements for governing the global economy: a Global Financial Regulatory Authority; a Global Competition Authority.

66. The Financial Stability Forum was created in the aftermath of the 1997-8 financial crisis in order to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to propagate from country to country, and to enhance the institutional framework to support global financial stability. It is now apparent that the reforms that it has proposed, although important, have not been sufficient to avoid major global financial instability. If it is to become the main instrument for the formulation of reforms of the global financial system it must take into consideration the importance of financial stability for the development of the real economy. In addition it must increase the representation of developing countries to adequately reflect the views and conditions in these countries and be made accountable to a democratically representative institution such as the Global Economic Coordination Council proposed above.

67. The development of financial institutions that are too big to fail has played an important role in the development of the crisis and has made the resolution of the crisis both difficult and costly, both for taxpayers and for the global economy. It is imperative not only that is adequate oversight of these large institution but that efforts be made to limit their size and the extent of their interactions, to limit the scope of systemic risk. This will require more effective global cooperation in financial and competition regulation. Movement towards this goal might be enhanced by taking steps to lay the groundwork for a Global Financial Regulatory Authority and a Global Competition Authority. With so many firms operating across borders, it is difficult to rely on national regulatory authorities. There may be large externalities generated by the action (or inaction) of national authorities. A potential, but partial, remedy to this difficulty is the proposal for a College of Supervisors to oversee systemically relevant global financial institutions. This could provide a basis for a more comprehensive Global Authority.

(f) Host Country regulation of foreign subsidiaries

68. In the absence of adequate global coordination, financial sector regulation will need to be based on the host country, not the home country, and may entail requiring the establishment of subsidiaries, rather than relying on branches.

(*g*) *Regulatory institutions*

69. While inadequate regulations are partly to blame for the current crisis, in some cases good regulations were not effectively applied and enforced. This highlights the need for reforms in regulatory structures, including reforms that make the possibility of regulatory capture less likely. The weaker is the system of global regulation, the more segmented will financial markets have to be to ensure global stability.

7. Support for Financial Innovations to Enhance Risk Mitigation

70. The absence of global systems of risk bearing and the absence of—and in some cases resistance to—innovations that would facilitate efficient risk bearing, such as GDP indexed bonds and mortgage products which better manage the risks associated with home ownership must be remedied. Governments and the international financial institutions need to explore meaningful innovations that would enhance risk management and distribution and how markets might be encouraged to do a better job. In particular, while there have been some expansion in capital markets in domestic currencies in developing countries, developing countries still bear the brunt of exchange and interest rate fluctuations. IFI lending in (possibly baskets of) local currencies and the provision of exchange and interest rate cover might be important steps in improving international risk markets.

8. Mechanisms for handling Sovereign Debt Restructuring and Cross-border Investment Disputes

71. There is an urgent need for renewed commitment to develop an equitable and generally acceptable Sovereign Debt Restructuring Mechanism, as a well as an improved framework for handling cross border bankruptcies. One way by which this might be done is through the creation of an independent structure, such as an International Bankruptcy Court. The United Nations Commission on International Trade Law provides a model that could be extended to the harmonization of national legislation on cross border disputes dealing with trade in financial services.

72. A number of countries may face difficulties in meeting their external debt commitments as the crisis worsens and debt rescheduling becomes more and more difficult due to an increase in creditors not represented in the Paris Club. The current crisis has already seen a number of bankruptcies of companies that operate across national borders, and their number is likely to increase. The absence of a formal mechanism for dealing with the impact of cross border bankruptcy and insolvency,

especially when related to financial institutions, transmits the adverse economic effects to the global economy.

73. It is especially important to achieve a uniform approach to financial and investment disputes on bankruptcy and insolvency, given the fact that the regulations dealing with these matters included in bilateral free trade agreements often transcend existing multilateral treaties and national legislation.

9. Completion of a Truly Development-Oriented Trade Round

74. There is a need for a true development round, to create an international trade regime which truly promotes growth in the developing countries. It is essential, that in all trade negotiations, the long recognized principle of special and differential treatment of developing countries be preserved.

10. More Stable and Sustainable Development Finance

75. The need for more and more stable sources of finance for development, including for the investments needed to address the long run challenges of responding to climate change, and new institutions for disbursement of funds, is discussed in Section III.4 above.

76. In the absence of better systems of risk mitigation, it is especially important for developing countries to be wary of measures that expose them to greater risk and volatility, such as capital market liberalization. Developing countries should use all the tools at their disposal, price interventions, quantitative restrictions, and prudential regulations, in order to help manage international capital flows.

77. Market-driven international capital flows are of a magnitude and volatility that they can offset any formal mechanism to provide additional finance for development. Thus, an active management of foreign capital inflows will be required to ensure that they are supportive of government counter-cyclical policies. The Articles of Agreement of the International Monetary Fund provided to members the facility of controlling capital inflows and expressly excluded the use of Fund resources to meet imbalances resulting from capital account disequilibrium. The Fund should thus be encouraged to return to its first principles and support countries that attempt to manage external flows in support domestic counter cyclical policy.

78. The international community needs to explore a variety of mechanisms of ***innovative finance,*** including regular emissions of a new global reserves (SDRs), revenues generated from the auction of global natural resources (such as ocean fishing rights and pollution emission permits), and international taxes (such as a carbon tax, which would simultaneously help address problems of global warming, or a financial

services tax, which would simultaneously help stabilize international financial markets.)

79. The receipts could be directed to support the developing countries costs of reducing greenhouse gas emissions in the context of their national policies to promote sustainable development. The effective implementation of national systems of taxation form a crucial part of domestic development finance. Measures must be taken to preserve national autonomy in the selection of the sources and methods of government financing while ensuring that national differences do not create incentives to evade responsibility of contributors to the support of government policies. An efficient method of achieving this result would be the acceptance by all countries of an amendment of Article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries to make the exchange of information automatic.

Information on the Commission of Experts is available in: http://www.un.org/ga/president/63/commission/financial_commission.shtml.

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NEW YORK
OFFICE OF THE PRESIDENT OF THE GENERAL ASSEMBLY

23 March 2009

Excellency,

I would like to draw your attention to the attached reference paper prepared by the International Labour Organization for the interactive dialogue on The World Financial and Economic Crisis and Its Impact on Development that will be held from 25 to 27 March 2009 at United Nations Headquarters in New York.

Please accept, Excellency, the assurances of my highest consideration.

Norman Miranda
Ambassador
Chef de Cabinet

All Permanent Representatives
and Permanent Observers
to the United Nations

ORGANISATION INTERNATIONALE DU TRAVAIL
BUREAU AUPRÈS DES NATIONS UNIES

ORGANIZACION INTERNACIONAL DEL TRABAJO
OFICINA PARA LAS NACIONES UNIDAS

INTERNATIONAL LABOUR ORGANIZATION
OFFICE FOR THE UNITED NATIONS

Jane Stewart
Special Representative to the United Nations and
Director

24 March 2009

Excellency,

In preparation for the Extraordinary Interactive Thematic Dialogue on The World Financial and Economic Crisis and Its Impact on Development which is to take place from 25 to 27 March 2009, it is my privilege to draw your attention to the attached executive summary of the document entitled: *"The financial and economic crisis: A Decent Work response"*. The complete paper, which can be accessed on the website of the President of the General Assembly, has also been submitted to the ILO's Governing Body Committee on Employment and Social Policy as well as to the High-level Tripartite meeting on the Current Global Financial and Economic Crisis.

This contribution will serve as a background to the discussion on the ILO's analysis of the origins and impacts of the international financial crisis which will be presented on 25 March at the above-mentioned thematic dialogue.

Please accept, Excellency, the assurances of my highest consideration.

Jane Stewart
Special Representative to the United Nations and
Director

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UN GENERAL ASSEMBLY

Extraordinary Interactive Thematic Dialogue on The World Financial and Economic Crisis and Its Impact on Development

AN ILO DISCUSSION PAPER

The financial and economic crisis: A Decent Work response [1]

[1] This paper is also being submitted to the ILO's Governing Body Committee on Employment and Social Policy as document GB.304/ESP/2 and to the High-Level Tripartite meeting on the Current Global Financial and Economic Crisis as document HTM/1.

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Executive Summary

The global crisis is deepening…

1. The world economy has been significantly affected by the financial crisis and prospects are the worst since the Great Depression. Already, the largest developed countries, notably those where the crisis originated, have entered into recession. Spill over to other countries was initially small, but several emerging economies are now being hit hard – assumptions about a "decoupling" of these economies have indeed proved wrong.

2. Developing countries too are facing the effects of the crisis, which will disrupt – and in some cases reverse – the achievement of Millennium Development Goals, including decent work for all. This is of particular concern given that, even in the pre-crisis period, growth patterns in certain regions, notably in Africa, led to only negligible reductions in poverty. Decent living and working conditions still remain out of reach for large numbers of people.

3. Importantly, the crisis is spreading throughout the real economy by means of three mutually-reinforcing transmission channels, namely: the limited availability of credit for working capital, trade finance and viable investments in the real economy (the credit crunch); cautious spending decisions, leading to lower output, employment and prices, in turn affecting confidence among consumers and investors (the vicious cycle of depression); and international trade and investment linkages and remittance flows (the globalization channel).

... and entails a risk of a prolonged labour market recession ...

4. The consequences of the crisis on labour markets have been visible since 2008, especially in the United States where the crisis originated. At the global level, after four years of consecutive declines, the number of unemployed increased in 2008 by 11 million. As the crisis continues to spread and job losses mount, worldwide unemployment could increase by an additional 40 million by the end of this year.

5. The bleak labour market picture affects certain groups disproportionately – notably women, migrant workers and youth. In some countries, the financial sector, construction and automobiles are suffering the most. In general, export-oriented sectors, which in many developing countries are major providers of formal jobs, notably for women, face the prospect of rapidly shrinking world markets. And the impact of the crisis on labour markets will go beyond job losses. In particular, the incidence of informal employment and working poverty will rise, aggravating pre-existing challenges.

6. The biggest risk is of a prolonged labour market recession. Lessons from past financial crises show that the labour market tends to recover only four to five years after the economic recovery (which is not expected before the end of 2009). This is because massive rises in long-term unemployment and greater labour market "informalization" – exacerbated by return migrants and large-scale reverse migration from urban to rural areas – are very difficult to reverse. If these trends take root, the negative effects of the

crisis will be long-lasting, thus yielding significant social hardship and depriving the economy of valuable resources.

... threatening social stability

7. Social hardship will be heightened in developing countries where social protection is often limited. But even in emerging economies and a number of developed countries, most new jobseekers do not receive unemployment benefits. The result is that millions of workers will be left without adequate support.

8. Pension systems are under severe strain as a result of the collapse of capital markets. Private pension funds have recorded substantial losses on their investments. Though the trends are often presented in overly technical language, one thing is clear: pension entitlements for workers who rely on such funds have been cut by over 20 per cent, on average. In some countries, even retirees have been left with the prospect of lower pension benefits. Importantly, well-designed public pension systems have been much less affected than private funds. This has motivated a policy shift in the stance of certain international organizations, which now advocate greater focus on more stable, security-oriented public pension systems. This is a much-welcomed development, though the damage has already been done and will be difficult to repair.

9. Finally, there is concern that the crisis is affecting all groups, while the gains of the pre-crisis expansionary period had been distributed unequally.

10. In short, a social crisis is looming large and can only be averted if adequate action is taken promptly.

Countries have attempted to address the crisis through the adoption of massive financial rescue measures and the announcement of fiscal stimulus packages…

11. Much of the focus to date has been on stabilizing financial markets and attempts to restore credit liquidity. At the same time, to stimulate the economy many countries have announced fiscal rescue packages – cutting taxes and boosting spending – of varying sizes. Several countries have also taken some action to mitigate the labour market and social consequences of the crisis. However, the amount committed for financial rescue measures has been for the most part far in excess of fiscal tools deployed to stimulate demand, output and employment.

...but the plans have not succeeded so far ...

12. It is commendable that countries have reacted so quickly, given the time lag for these packages to reach the real economy. Nevertheless, the impact of the measures has been limited to date. This is because, as evidenced from the over 40 rescue and stimulus plans assessed for the purposes of this paper, the transmission mechanisms through which the crisis is spreading have not been fully addressed. And the measures have often failed to tackle the structural imbalances that lie behind the crisis.

… because the credit system has not been revived…

13. First, rescue measures to banks, though of unprecedented magnitude, have not revived bank credit. To avert the risk of systemic collapse, developed countries have rescued financial institutions through capital injections, credit guarantees and sometimes outright assumption of bad loans. Indeed, protecting banks' solvency and restoring the availability of credit to enterprises and households was rightly regarded as a pre-condition to avoid a total collapse of the financial system, with unpredictable consequences for the real economy. However, access to bank credit remains limited.

... fiscal packages do not focus sufficiently on decent work and are not coordinated, thus failing to boost the economy…

14. Second, fiscal stimulus measures announced by governments are generally on a lower scale than rescue support to banks. In addition, they mostly do not focus sufficiently on employment and social protection. For instance: only a handful of countries have announced labour market initiatives; infrastructure programmes do not adequately take into account the need to reinforce the existing capacity of businesses and skills supply – so that part of the infrastructure spending may result in higher prices, rather than higher production and jobs; and some tax cuts will end in higher savings rather than higher demand, output and jobs. The measures moreover involve only limited social dialogue with employers and unions and lack coordination across countries.

15. Lack of international coordination obviously diminishes the overall effect of the stimulus measures. But it also makes each individual country reluctant to move faster than its trading partners, given the international linkages. As a result, practical implementation of the fiscal packages may be postponed further, aggravating the vicious cycle of depression.

… world markets face the risk of inward-looking solutions, competitive devaluations and wage deflation…

16. Third, world markets are affected by the credit crunch (which dries up trade finance available to enterprises) and face the risk of inward-looking solutions and protectionist responses. The repercussions for developing countries, which rely so heavily on world markets, would be especially acute. This is why the multilateral system should remain vigilant vis-à-vis the mounting pressure to support strategic sectors like automobiles. Likewise, attempts to overcome the crisis through competitive currency devaluations would be counterproductive.

17. Generalized wage deflation to protect individual economies would aggravate the crisis even more than a wave of competitive devaluations. Indeed, wage deflation would deprive the world economy from much-needed demand and would also seriously undermine confidence. Open market policies, which are so crucial to the recovery, would also face a risk of backlash if workers perceive the measures as unfair.

… little attention has been devoted to the development dimension…

18. Fourth, inadequate attention has been given to the development perspective. The social impacts of the crisis in developing countries are exacerbated by the fact that the majority

of workers and small businesses do not have basic social security. It is expected that between 40 and 50 per cent of men and women globally will not be able to earn enough to lift themselves and their families above the two US dollars a day poverty line in 2009.

19. Moreover, many developing countries lack the capacity to undertake massive public investments. Already a number of countries are facing sizeable fiscal and current account deficits on the heels of the food and fuel price crisis of mid-2008. If the gap between countries widens even further as a result of varying capacities to respond to the crisis, global imbalances and inequalities will intensify.

20. Traditional International Monetary Fund (IMF) packages to support countries that undergo balance of payments crises are simply not adapted to the situation. Such packages were based on an approach that assumed countries faced local crises, for which the countries involved themselves had the main responsibility. The current crisis, however, is global and originates in the developed world. A multiplication of traditional rescue packages would further aggravate the decline in world demand and perpetuate the global crisis. This is why a new mechanism, which would coexist with IMF rescue packages, rather than replace it, is needed.

… and the structural causes of the crisis have not been tackled

21. Fifth, the stimulus measures have, so far, not been deployed with a view to ensuring that global growth is more equitable and sustainable in the medium to longer term. Global imbalances, decent work deficits and inequalities have been a significant contributor to the crisis. Likewise, reflecting poorly regulated financial markets, the real economy has been subject to pressure to raise returns in the short run, sometimes to the detriment of workers' incomes and the long-term interests of sustainable enterprises. It is vital to tackle the root causes of the crisis to support the recovery, reduce the risk of another major systemic crisis and promote a sense of fairness. Reverting to the "status quo" is not an option.

What is needed is a global jobs pact

22. Moving ahead with the Decent Work Agenda is crucial to supporting the economic recovery, averting the labour market and social crises and promoting social cohesion on the measures. In the global crisis context, this is best done through a global jobs pact.

23. A *global* approach is needed because the measures, to be effective, need to avoid beggar-thy-neighbour solutions to a crisis which is global in nature. The emphasis on *jobs* comes from evidence provided in this paper that it will not be possible to reactivate the economy in a sustainable manner unless greater emphasis is placed on decent and productive employment for women and men, well-designed social protection and workers' rights. Measures are best implemented through social dialogue in countries, but greater cooperation at the international level can also have mutually-reinforcing benefits – thus the need for a *pact*.

24. The global jobs pact would build on the ILO's Global Employment Agenda and the November 2008 statement by the Officers of the ILO Governing Body. In essence, the

global jobs pact seeks to support economic recovery through decent-work friendly policies, reduce the risk that the crisis spreads further across countries and pave the way for a more sustainable, fairer globalization. This is how.

25. To ***restore credit***, governments could consider:

- Making financial support, such as government's assumption of toxic assets, conditional on: beneficiary banks providing new credit for viable projects of businesses and individuals; and limitations to managers' pay and dividend policy, so that government support does not miss the target of reactivating credit.
- Providing credit lines and direct access to government loans to small businesses (important drivers of innovation and employment growth) so they can maintain operations (and seize potential new opportunities) until demand is restored.

26. ***Fiscal stimulus packages would provide a much stronger boost to the economy and jobs, while also proving cheaper than current packages,*** if the following conditions were met:

- Ensuring that infrastructure, construction and housing projects leverage capacity among existing businesses by: giving small and medium-sized enterprises (SMEs) support to take advantage of new opportunities; ensuring that workers have the skills to respond to new requirements; and promoting the rural and agricultural dimensions of the projects, which are crucial for developing countries as they would help boost domestic economic and job dynamism and attenuate the looming food crisis.
- Given the lags in launching infrastructure, construction and housing projects, it would be helpful to: provide support to existing jobs in viable firms through shorter working hours, partial unemployment benefits and training; reduce labour taxes on low-wage employment; and enhance social protection through well-designed programmes that support aggregate demand and are consistent with work incentives. This could include conditional cash transfers to enhance access to education and health services, and unconditional transfers in countries where poverty is widespread and administrative capacity is limited. More structural measures are also needed however, so that social protection becomes broad-based.
- For job losers and new entrants who do not find jobs, the following measures proved useful in earlier crises: putting in place at least minimal unemployment benefits or employment guarantees for those not able to access income support (experience from the Asian crisis shows successful performers overcame the crisis partly through these new, cost-effective schemes); active labour market programmes and training administered through solid, well-resourced public employment services (evidence shows that these services, if well functioning, are crucial at times of crisis and are cost-effective relative to other measures); and specific programmes and approaches to vulnerable groups, notably women who return to the labour market after maternity leave, youth, who could also be encouraged to stay longer in education, and migrant workers.
- To the extent that specific industrial sectors need support, such support should be: subject to strict social and environmental conditionality; and targeted and coordinated globally, consistent with international trade agreements.

- Enhance fiscal space, administrative capacity and technical support to developing countries in the event of global crises, possibly through the creation of a global jobs fund. Unlike the IMF rescue packages, this fund would be anti-cyclical. The global jobs fund would not be subject to cuts in social spending and wage deflation (which not only depress the domestic economy but also affect neighbouring countries, exerting further downward pressure on world demand). Recipient countries could take advantage of ILO expertise in developing the various dimensions of the global jobs pact. They would engage social partners in the design of the measures. Repayment of the fund's loans, possibly larger in scale than traditional rescue loans, would be made easier because the system is anti-cyclical in nature, and thus supports the global recovery, and is designed to promote domestic economic capacity.

27. ***Avoiding wage deflation through coordinated systems of collective bargaining and protecting workers' rights*** would not only provide adequate support to victims of the crisis, but would also ensure a timely demand stimulus and pave the way for a more sustainable economy. As such, the global jobs pact would also comprise the following measures:

    - Strengthening respect for core workers' rights, as this would be both socially desirable and economically efficient to achieve more balanced income developments.
    - Building the capacity of social partners for dialogue and reach agreements at various levels so that wages for the economy as a whole grow in line with productivity developments (and not below them as was the case over the past two decades).
    - Guaranteeing the purchasing power of minimum wages, so that they act as anchor to all wages.
    - Avoiding wage deflation to support global demand and reduce trade tensions.

Global policy coherence for shared prosperity and development:

28. Now is the time to enhance cooperation among key international organizations. This is key to speed up the recovery. Indeed, inward-looking solutions would be counterproductive. More fundamentally, the crisis is global and multi-faceted, so no organization or country is equipped to address all its dimensions. This is why the ILO has reaffirmed the importance of fostering greater cooperation among national governments, international organizations, and other stakeholders in support of a stronger, cleaner and fairer economy. International partners can increase coherence between financial, trade, social, environmental and development goals. This also implies a reprioritization between these goals, to:

    - ensure that the financial system serves the real economy and social development, through a deep reform of the financial architecture and the implementation of executive compensation packages that are reasonable and geared towards real performance;
    - re-balance the globalization process, as stated in the ILO Declaration on Social Justice for a Fair Globalization (the Social Justice Declaration), and in particular address the decent work gaps, and excessive income inequalities as well as the

growing incidence of informal and non-standard employment that developed during the pre-crisis period;

- pave the way for a green economy, given that future spending will be limited by the need for governments to tighten budgets so as to repay mounting public debt after the economy recovers. Importantly, green technologies tend to be more job-rich than their CO2-intensive counterparts – hence the Green Jobs agenda; and
- ensure that official development aid is not affected by the crisis and establish a new mechanism such as the global jobs fund, to complement existing measures and support adjustment of emerging and developing countries at times of crisis.

29. Debates at the G20 could offer an opportunity to discuss these issues, as well as the global jobs pact. In addition an exchange of good practices could take place at the ILO, so that countries benefit from each other’s experiences and take advantage of the expertise developed at the ILO.

30. In sum, responses to the crisis must *not* be piecemeal in nature and rolled out temporarily, only to revert back to “business as usual” as soon as possible. The challenge now is to respond to the current crisis by putting in place measures that pave the way for a better pattern of growth and development.

Introduction

31. What started as a mortgage crisis in the United States in the latter half of 2007 has now developed into a global economic crisis, bringing with it unprecedented labour market and social challenges across advanced, emerging and developing countries.

32. The objective of this paper is to provide evidence-based policy analysis of how ILO members can best mitigate the challenges facing enterprises and workers. The first section of the paper reviews recent developments, discusses the origins of the crisis and how the damaging effects have spread from developed countries to other parts of the world, and from the financial economy to the real economy, employment and society.

33. The second section examines current international and national responses to the crisis, including financial and fiscal policy measures, labour market initiatives and social dialogue. The aim of this section is to assess the breadth and depth of the responses and identify potential gaps.

34. In building upon the lessons learned and measures taken to date, the third section of the paper examines the key ingredients to overcoming the crisis, and the role of the ILO in addressing the challenges.

35. The last section discusses how best to respond to the crisis through measures that support a recovery while meeting the longer-term goal of achieving a more sustainable and equitable pattern of development, as provided in the Social Justice Declaration.

I. Crisis spreads worldwide and entails risk of prolonged social crisis

The largest developed countries, notably those where the crisis originated, have already entered into recession …

36. The global economy is experiencing the worst economic crisis since the Great Depression. What began as a financial crisis when the housing market in the United States turned sour has now expanded into a global meltdown, wiping away trillions of dollars of financial wealth, putting the real economy at grave risk of prolonged recession, and causing significant job losses and widespread social hardship.

37. The IMF predicts that world output will grow at 0.5 per cent this year, the lowest rate since the Second World War (Table 1). In comparison, in 2007 and 2008, world output grew by over 5 per cent and 3.4 per cent, respectively. The European Union (EU), Japan, the United States and other large developed economies have already entered into recession or are on the brink of doing so. The UN's Department for Economic and Social Affairs (UNDESA) has confirmed the IMF's bleak economic prospects for 2009. And private-sector analysts such as the Deutsche Bank paint an even direr scenario, with world output actually falling in 2009.

Table 1. World Economic Outlook*

	IMF		Deutsche Bank	UNDESA
	2008	**2009**	**2009**	**2009**
World output	3.4	0.5	-0.8	1.0
United States	1.1	-1.6	-2.7	-0.9
Euro Area	1.0	-2.0	-3.0	-0.7
Japan	-0.3	-2.6	-7.6	-0.3
Brazil	5.8	1.8	1.2	2.9
China	9.0	6.7	7.0	8.4
India	7.3	5.1	4.8	7.0
Russian Federation	6.2	-0.7	-2.4	4.8
South Africa	:	:	:	2.5
Africa	5.2	3.4	:	4.1
ASEAN-5	5.4	2.7	:	:
Central and Eastern Europe	3.2	-0.4	:	:
Western Hemisphere	4.6	1.1		
Middle East	6.1	3.9	:	:

* IMF and UNDESA forecasts are from January 2009 and Deutsche Bank from 25 February 2009.
Source: IMF, Deutsche Bank and UNDESA.

…and the crisis is now spreading to the rest of the world…

38. Spill over to emerging and developing economies was initially small, but the crisis has now spread worldwide and from financial markets to the real economy through a number of transmission mechanisms (Box 1).

Box 1. **The crisis: causes and transmission mechanisms**

The crisis has been brought about by a combination of inappropriate financial regulations, excessive risk-taking of certain financial intermediaries and inefficient remuneration practices of bank managers and traders. But it is the interaction between these financial factors and global imbalances that lies at the heart of the crisis:

- Since the early 1990s, significant savings-investment imbalances built up. This is partly the result of export-oriented growth strategies in some countries, and insufficient savings in others. Lack of exchange rate adjustments contributed as well.

- Within countries, income inequalities grew significantly since the early 1990s. Stagnating wages and incomes for a majority of workers in some countries spurred demand for credit to sustain consumption possibilities and housing investment decisions. Interestingly, a rise in the share of over-indebted households has been observed in all the countries where income inequalities have increased.

- This was made possible by lightly regulated financial practices that allowed excessive debt accumulation and focused on short-term returns (because of skewed compensation packages) rather than long-term investments in the real economy. When housing markets reached a turning point and interest rates rose, over-leveraged low-income households defaulted on payments and foreclosures rose significantly. As the value of the assets plummeted, banks had to finance foreclosures, and effectively stopped lending to each other, causing liquidity to dry up substantially.[2] In short, financial markets have tended to operate to the detriment of labour market stability and sustainable enterprises.

The crisis then spread to the real economy, and beyond developed countries, through three channels.

First, the crisis spread through the financial system via the process of "securitisation" of "toxic assets". Direct exposure to toxic assets led to some localized bank failures, but more broadly, inter-bank credit was affected and as a result, the volume of new credit available to the real economy declined. Even businesses with a long record of creditworthiness have had credit lines cut and have had difficulty selling their bonds. This abrupt freezing up of the normal credit lines needed for trade, coupled with the inability of companies to raise capital for seemingly profitable business opportunities and investment plans, created the so-called "credit crunch".

Second, over and above the credit crunch, the crisis is gaining its own dynamics in the real economy through the confidence channel. Consumers and investors lack confidence and postpone their spending decisions. This affects firms' prospects and leads to job losses, further aggravating confidence.

Third, the crisis is spreading worldwide through international linkages, so even countries with

[2] This issue is discussed in detail in ILO: *A global policy package to address the global crisis*, Policy Brief, International Institute for Labour Studies (IILS), Geneva, 2008.

relatively healthy financial systems are being affected:

- World trade is estimated to contract by 2.8 per cent in 2009 after growing at an average annual rate of 7.8 per cent for the last three years.[3] This has dire consequences for economies around the world, especially the export-led economies of Asia and Latin America. Moreover, global trade activity is also negatively affected by the scarcity of trade financing.

- Some trade prices, notably for oil and other commodities, declined significantly as a result of the recession. As such, oil and gas producers like Mexico, Middle Eastern countries, the Russian Federation and the Bolivarian Republic of Venezuela face a sudden reduction of export revenues. Likewise, declines in prices of metals such as nickel, lead and zinc have deeply affected countries such as Australia, Brazil and South Africa. Lower commodity prices – though improving the terms of trade for importing countries – have not outweighed the other negative forces at work.

- Foreign direct investment and other private capital flows are affected as well. In particular, private capital flows to emerging economies are expected to fall to $165 billion in 2009. From the high of $929 billion in 2007, this represents an unprecedented drop of 82 per cent.[4] This has implications for development, since one third of growth in emerging countries comes from investment.[5] Reduced flows of capital may have a dramatic effect on countries with large current account deficits and with a limited ability to borrow from abroad.

- It is likely that, for the first time in decades, remittances will fall, impacting the economic security of households around the globe. Remittances represent more than 10 per cent of GDP in over twenty countries, and in some cases as much as 24 per cent.[6] For many countries, remittances are larger than the amount received in Official Development Assistance. The negative impact of falling remittances on the developing world could be in the order of $3 billion per year.[7]

- Although donor countries have committed not to reduce development aid in several international fora, this commitment might eventually come under pressure in view of declining outputs in major industrialised countries.

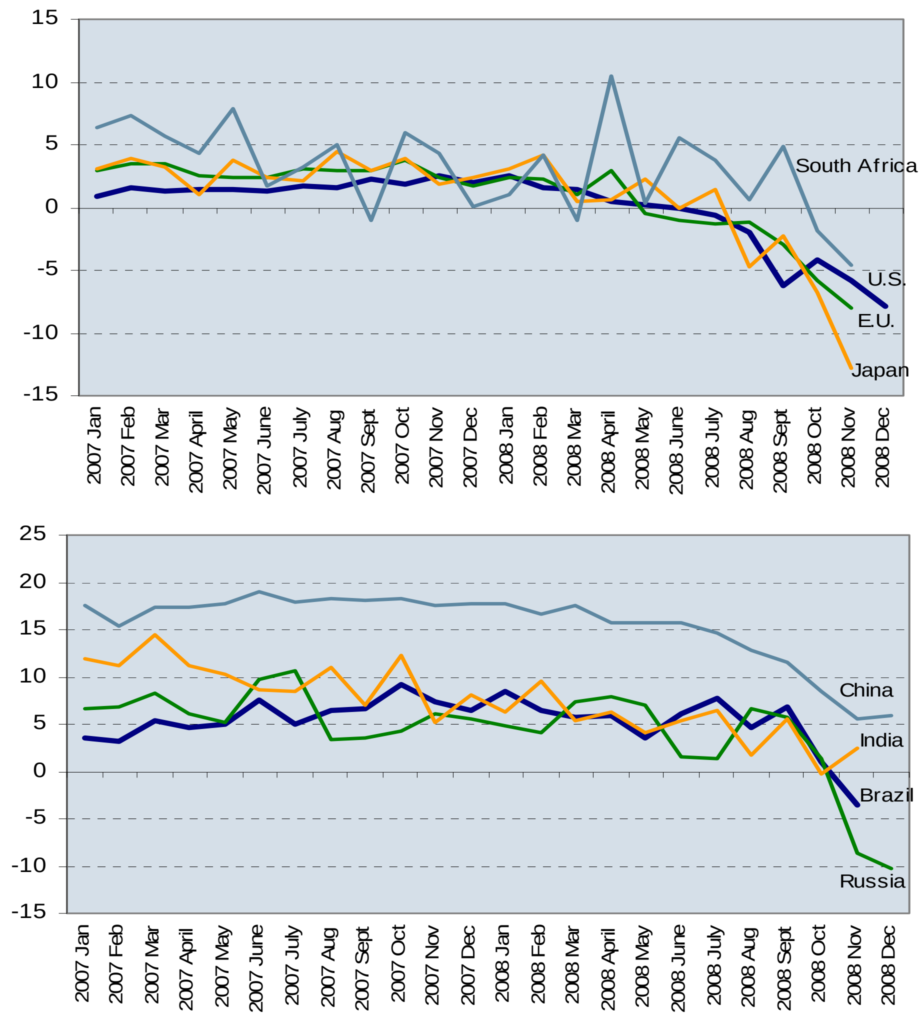
39. Large emerging economies are being hit hard by the crisis – assumptions of a "decoupling" of these economies have proved wrong. During the second half of 2008, industrial output slowed significantly and even contracted in some large emerging economies (Figure 1).

40. Other emerging and developing countries are also being affected. There is a risk that the development path will be seriously disrupted and in some cases reversed. This could compromise the attainment of the Millennium Development Goals, notably "full and productive employment and decent work for all, including women and young people".

[3] World Trade Organization: *Annual Report*, 2002.
[4] Institute of International Finance: *Capital Flows to Emerging Market Economies*, 27 January 2009.
[5] UNCTAD: *Trade and development report: Commodity prices, capital flows and the financing of investment*, 2008.
[6] World Bank: *Migration and Development Brief*, 29 November 2007.
[7] Under the assumption that remittances fall 2 per cent globally – in line with the estimated decline in Latin America (Inter-American Development Bank: *IADB estimates of 2008 remittance flows to Latin America and the Caribbean*, October 2008).

Decent living and working conditions still remain out of reach for a large number of people.

Figure 1. Monthly change in industrial production (percentage)



Source: World Bank.

…with severe impacts on certain sectors

41. Certain sectors are being disproportionately affected by the crisis. The effects on financial services and construction – the sectors at the epicentre of the crisis in developed countries – have been immediate and profound.[8] In a second round, those sectors most affected by the credit squeeze and confidence effects, like automobile production, were hit.[9] Export-oriented activities, tourism and commodity sectors are now suffering from

[8] See GB.304/STM/2/2 and V. Escudero: *Effects of the Crisis on the Financial Sector: Trends and Policy Issues*, Discussion Paper, IILS, ILO, forthcoming 2009.

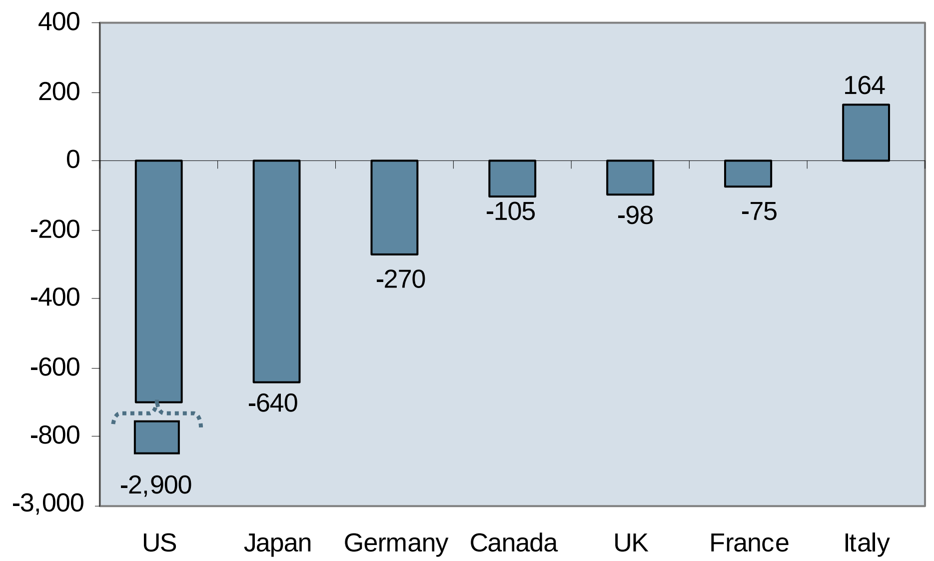
[9] Two-thirds of cars in the world are purchased with credit. However, it is important to note that even before the current crisis, the automotive sector was facing a number of challenges, including decreased demand for relatively high-profit vehicles due to volatile fuel prices and geographical relocation of some operations to areas with low labour costs. See GB.304/STM/2/2.

rapidly falling world demand and declining prices. The impact on developing economies that rely heavily on a narrow, commodity-based export sector, is dramatic.

Global unemployment rose in 2008 and employment levels have declined significantly in advanced economies…

42. As growth rates declined in 2008, the effects on the labour market started to be felt. After four years of consecutive declines, the global unemployment rate increased to 6 per cent in 2008, up from 5.7 per cent in 2007, and the number of unemployed rose by 11 million.[10] The impact was immediate and particularly severe in the United States, where employment losses started in early 2008 and have continued to mount since. Similar trends are present in Japan (Figure 2). In European countries, job losses have been contained to some extent due to recourse to shorter hours or partial unemployment benefits. However, even there, recent indicators suggest significant increases in unemployment.

Figure 2. **Employment declines in 2008 in the G7 (000s)**



Source: International Institute for Labour Studies (IILS) estimates based on national sources.

…with already visible impacts on emerging and developing countries...

43. In other countries, the job losses stemming from the crisis have only just begun and so the full extent of the impacts on labour markets may not be felt for some time. Nevertheless, there are early and clear indications that the crisis is impacting labour market and social conditions in emerging economies and developing countries:

- Following job losses in factories on the industrialized eastern coast of China, more than 20 million workers have reportedly returned to their residential rural areas.[11]
- During the last quarter of 2008, employment in eight export-oriented sectors in India (mining, textile and textile garments, metals and metal products, automobile, gems and jewellery, construction, transport and information technology) fell by over 3 per cent.[12]

[10] ILO: *Global Employment Trends*, January 2009.
[11] China national statistics, Ministry of Agriculture.

- The South African economy may lose a quarter of a million jobs as a result of the crisis and this is likely to undermine government plans to cut the unemployment rate to 14 percent by 2014.[13]
- Reflecting a sudden deterioration in the economic outlook, Central and Eastern European countries are experiencing a dramatic reversal of earlier, hard-won employment gains.
- Significant job losses have been recorded in developing countries that rely heavily on a narrow export base. For instance, in Africa, employment levels in commodity production and tourism have declined significantly in recent months.

44. In these countries, job losses will exacerbate challenges of employment informality and working poverty. In the absence of income support alternatives, job losers either move back to rural areas or take up informal jobs in the urban economy.[14] This has started to happen, according to an ILO report.[15] For instance, a reversal in rural-to-urban migration flows has been noted in China and, in Africa, workers who had formal jobs in export-oriented sectors have been pushed to the informal economy where they will earn lower wages. As a result, between 40 and 50 per cent of the world's working men and women in 2009 are not expected to earn enough to lift themselves and their families above the $2 a day per person poverty line.[16]

… and disproportionate effects on vulnerable groups such as women, youth and migrant workers

45. Groups that were already in a vulnerable position before the crisis will be disproportionately affected, while temporary and migrant workers are also usually not protected by collective bargaining agreements.[17]

46. The crisis is already having differentiated employment and social impacts from a gender perspective. Many of the job losses to date in advanced economies, especially the United States, have been in male-dominated sectors such as finance and construction.[18] However, in many developing countries, women are often in more precarious employment situations.[19] In particular, the concentration of women in export-oriented enterprises in emerging and developing countries brings a number of acute labour market challenges (Box 2).

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[12] C.P. Chandrasekhar; J. Ghosh: "Asian face of the global recession", in *The Hindu Business Line* 10 February 2009.
[13] N. Seria; M. Cohen: "Manuel Cuts South African Growth Forecast to Decade Low of 1.2 per cent", in *Bloomberg.com*, 11 February 2009.
[14] G. Betcherman; R. Inslam (eds.): *East Asian Labour Markets and the Economic Crisis*, World Bank, 2001.
[15] ILO Regional Office for Asia and the Pacific: *The Fallout in Asia: Assessing labour market impacts and national policy responses to the global financial crisis*, prepared for the forum Responding to the Economic Crisis – Coherent Policies for Growth, Employment and Decent Work in Asia and Pacific, Manila, 18-20 February 2009.
[16] ILO: *Global Employment Trends*, January 2009.
[17] The impact on vulnerable groups varies by country and time period under consideration (see for example, ILO: *Global Employment Trends for Women*, March 2008).
[18] Of the 2.9 million jobs losers in the United States in 2008, 2.3 million were male.
[19] ILO: *Global Employment Trends for Women*, March 2008.

Box 2. Impact of the crisis on women's employment[20]

The crisis has already hit major exporting industries dependent on American and European markets, such as labour-intensive sectors of developing countries. This includes clothing, footwear and processed foods, as well as micro-circuits and electronic products. Since women make up the majority of the workforce in these sectors, their labour market position has worsened considerably.

More generally, women are often regarded as a flexible reserve, to be drawn into the labour market in upturns and expelled in downturns.[21] Women are also over-represented among casual and temporary employment, contract labour and home workers. They also tend to earn lower wages than their male counterparts and the crisis is likely to worsen the situation in this regard.

47. Youth are facing considerable difficulties entering the labour market.[22] This comes on top of an already fragile situation for youth in both developed and developing countries. Even during the previous period of economic expansion, most economies fell short of creating enough decent and productive jobs for young people. Between 1997 and 2007, the number of unemployed youth rose by 8 million.[23] Moreover, a lack of decent work opportunities at an early age may permanently compromise the future employment prospects of youth. The relative disadvantage of young workers is even more pronounced in developing countries.[24]

48. As employment losses mount, migrant workers are particularly vulnerable and often among the hardest hit, due in part to their low bargaining position (especially among newly arrived migrant workers). Evidence from past crises reveals that for the most vulnerable migrant workers, especially women and those in irregular status, this often translates into significant job loss. For those able to maintain employment, a serious deterioration in working conditions is often registered.

The prospects are for a continued deterioration in labour market and social conditions…

49. The global number of unemployed persons could rise by 20 million in 2009.[25] If the outlook worsens to the point where increases in unemployment match the magnitude

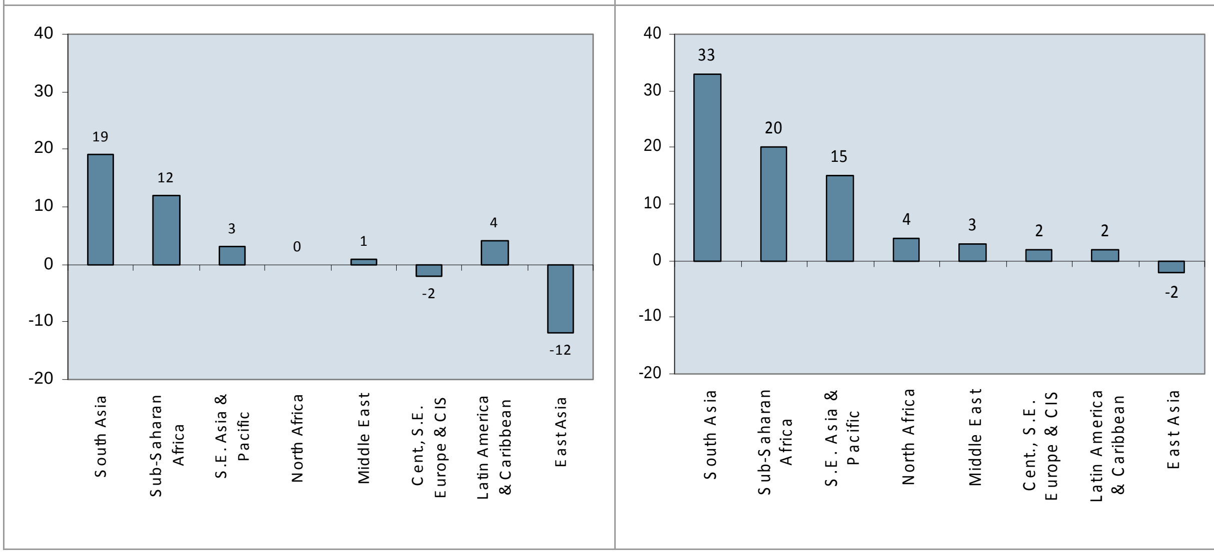
[20] A. King-Desjardin; J. Owens: *The global economic crisis: impacts and responses from a gender perspective*, ILO, forthcoming 2009.
[21] Studies of economic recessions in several developed countries in North America, Europe and Asia show that women's employment moved pro-cyclically, and significantly more pro-cyclically than men's (J. Rubery (ed): *Women and Recession*, Routledge & Kegan Paul, London, 1988). In addition, women's integration into the workforce in the 1980s was generally associated with their providing forms of labour market flexibility (G. Standing: "Global feminisation through flexible labour," World Development, Vol. 17, No.7, 1989).
[22] For example, in Spain, during the fourth quarter of 2008, employment decreased for most age groups, but the drop, at 10 per cent, was particularly severe for 20-24 year olds.
[23] ILO: *Global Employment Trends for Youth*, October 2008.
[24] *Ibid.*
[25] ILO: *Global Employment Trends*, January 2009. Scenario 2: Projection on the historical relationship between economic growth and unemployment at times of crises in each economy; IMF revised estimates for economic growth, November 2008.

witnessed in the 1990s, then unemployment could rise by 50 million, bringing the global unemployment rate above 7 per cent.[26]

50. Likewise, vulnerable employment, as measured by own-account workers and contributing family workers, is expected to rise by some 25 million (Figure 3, Panel A). The majority of the increase is expected to occur in South Asia and Sub-Saharan Africa.

Figure 3. Projected increase in vulnerable employment and working poverty, (millions, change from 2007 to 2009)

Panel A. Vulnerable Employment | Panel B. Working Poor (<$2/day)



Source: ILO: *Global Employment Trends*, 2009.

51. As was the case in previous crises, this could generate substantial downward pressure on informal-economy wages, which before the current crisis were already declining and are substantially lower than for regular workers.[27] This is also likely to lead to a reduction in the number of days worked.[28] This combination of factors will reduce incomes at the household level and erode purchasing power, leading to an increase in the proportion of working poor in most developing economies (Figure 3, Panel B). Based upon a threshold of $2 per day, over 2008 and 2009 the incidence of working poverty is expected to rise across all developing regions. This will add over 75 million people to the working poor, with most of the increase occurring in South Asia and Sub-Saharan Africa.

52. Rising working poverty will compound the effects that the increase in food prices has had on the poor in developing countries (Box 3). And while prices have now fallen, given their recent volatility there is a risk that then when demand for food commodities recovers, the challenges associated with poverty will intensify.

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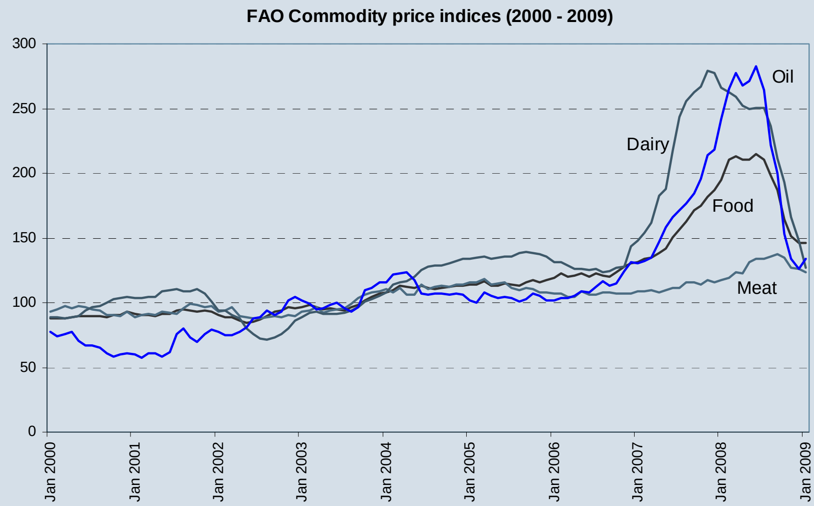
[26] *Ibid.* Scenario 3: Projection on the basis of a simultaneous increase in the unemployment rate in the developed economies and the European Union equal to the largest increase since 1991 and half of the largest increase since 1991 in economies in other regions; IMF revised estimates for economic growth, November 2008.
[27] ILO: *World of Work Report. Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.
[28] G. Betcherman; R. Inslam (eds.): *Op.cit*.

Box 3. Unstable food prices and impact on the poor

The rise in food prices between 2005 and 2008 is estimated to have increased the share of the population of East Asia, the Middle East, and South Asia living in extreme poverty by more than 1 percentage point. The impact on Africa was relatively lower because food prices increased somewhat less than in other regions. As the poor in developing countries spend 50 percent or more on food, the increase in food prices had a disproportionate impact on them. Since July 2008, prices of all commodities, including food items, have fallen sharply mainly reflecting declining world demand. However, food prices remain well above the levels reached in the 1990s.[29]



Source: Food and Agriculture Organization of the United Nations (FAO), February 2009.

… entailing a risk of prolonged labour market recession

53. Previous crises show that it take much longer to reach pre-crisis employment levels than to restore economic growth – with the impact from banking-related crises often being deeper and more prolonged (Box 4).

Box. 4 Aftermath of banking crises and employment recovery after recessions

Banking crises typically have long-lasting effects on employment.[30] Earlier crises caused, on average, a drop in GDP for approximately two years and increases in unemployment for a much longer period – 4 to 5 years. Furthermore, as growth of government revenues weakens significantly in the year of a crisis and declines in the following years, the real value of government debt tends to surge, rising an average of 86 per cent. Thus, the fiscal consequences of banking crises reach beyond the immediate sector-specific bailout costs.

The figure below shows the duration of the last two recessions in the United States (1991 and 2001).

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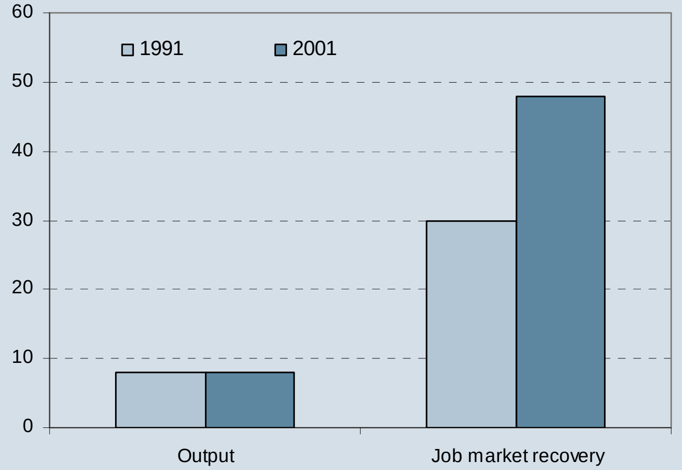
[29] *Ibid.*

[30] See C.M. Reinhart; K.S. Rogoff: *Banking Crises: An Equal Opportunity Menace*, National Bureau of Economic Research (NBER), Working Paper No. 14587, 2008a; and C.M. Reinhart; K.S Rogoff: *The Aftermath of Financial Crises*, paper prepared for presentation at the American Economic Association, 2008b.

Both recessions lasted eight months (according to the National Bureau of Economic Research), but the job market recovery took 30 months in the case of the 1991 recession and 48 months in the 2001 recession. In other words, not only does it take much longer for the job market to recover in response to a recession, but the time it takes for such recovery to materialize seems to have increased in recent years.

Duration of output recovery and job market recovery after the 1991 and 2001 US recessions (in months)



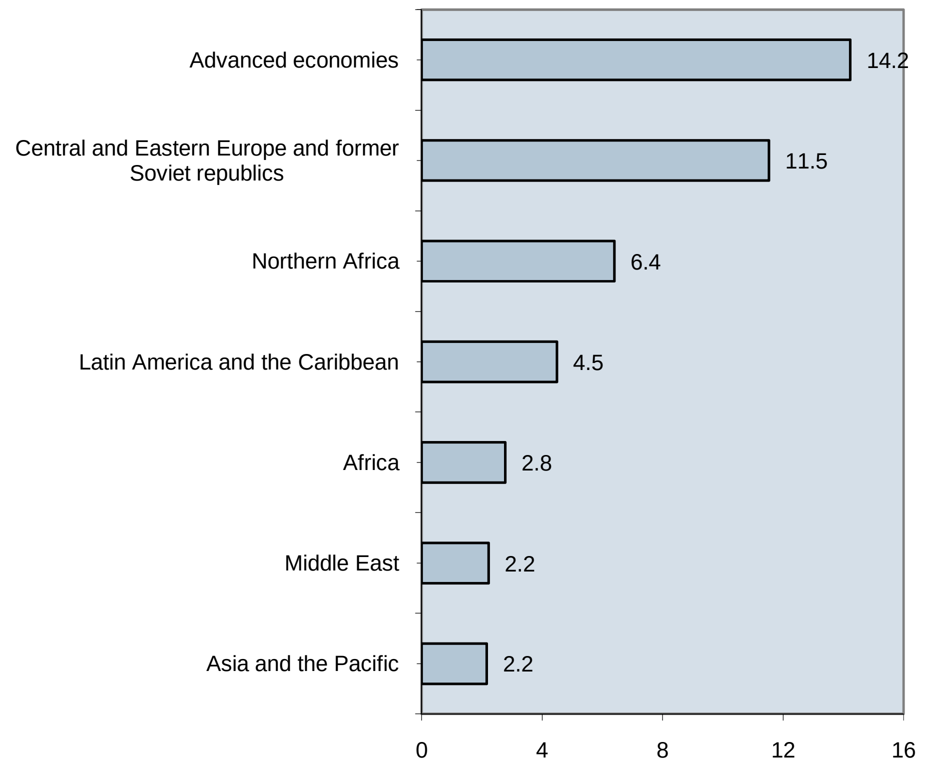
Source: J. Irons, *How long would a job-market recovery take?*, Economic Policy Institute, 7 January 2009.

Depending on social protection coverage, the labour market recession will lead to significant social hardship...

54. Social protection, if well designed, plays a crucial role in alleviating social hardship in the face of the crisis. Yet, the array of benefits and support measures available to individuals varies significantly across countries and regions. Social spending as a share of GDP ranges from as high as 14 per cent in advanced economies to as low as 2 to 3 per cent in Asia, the Middle East and Sub-Saharan Africa (Figure 4). The reality is that in many emerging and developing countries, the majority of workers do not contribute to basic social security coverage, including unemployment benefits.[31] This is due mainly to the fact that most employment is in the informal economy.

[31] It is important to note that in many countries – emerging, developing and developed – unemployed workers often have access to other benefits and support (e.g. social assistance, training, etc.).

Figure 4. **Social expenditures as a per cent of GDP, most recent year available***



* Social expenditures (consolidated central government) are defined as transfers to protect the entire population against certain social risks such as medical services, unemployment compensation, social security pensions, and social assistance benefits. Social security benefits include sickness and invalidity benefits, maternity allowances, children's or family allowances, unemployment benefits, retirement and survivors' pensions, and death benefits. Subsidies, grants, and other social benefits include all unrequited, non repayable transfers on current account to private and public enterprises; grants to foreign governments, international organizations, and other government units; and social security, social assistance benefits, and employer social benefits in cash and in kind.

Source: IMF: Government Financial Statistics, 2007.

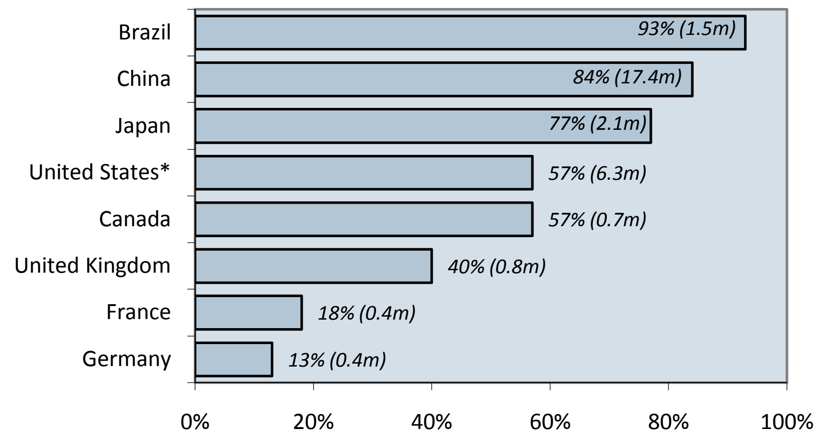
…as millions of workers are left without adequate support…

55. Even where unemployment benefit systems exist in emerging and developing economies, they are often restricted to urban areas. For example, in China, close to 5 million unemployed urban workers (57 per cent) were without unemployment insurance in 2005. Given that over 60 per cent of total employment in China is in rural areas, the share of unemployed workers unable to access unemployment benefits is probably closer to 84 per cent (Figure 5).

56. In many developed countries, job losers are often not eligible for unemployment benefits. In half of the OECD member countries, 50 per cent or more of the unemployed do not receive unemployment benefits (though non-recipients may be entitled to social

assistance benefits).[32] Even in countries like France and the United Kingdom, where coverage is greater, many workers do not receive unemployment benefits (Figure 5).

Figure 5. **Share (and number) of unemployed workers NOT receiving unemployment benefits**



* For the United States, if benefits under the extended unemployment compensation programme authorised by Congress in the summer of 2008 are also included, the rate declines to 42 per cent.

Source: IILS estimates based on national statistics. For Brazil, recipiency rate is taken from Vroman and Brusentsev: *Unemployment Compensation Throughout the World: A Comparative Analysis*, 2005, and applied to the level of unemployment from the December 2008 Labour Force Survey.

57. In Canada, Japan, and the United States, where regulations governing access to such benefits are often much stricter, the share of unemployed workers not receiving benefits can be well over half. As of January 2009, more than 6 million jobless Americans were *not* receiving unemployment insurance. In Japan, about 77 per cent of unemployed persons do not receive unemployment benefits.

58. The absence of unemployment benefit support is made worse by the fact that for many individuals social protection is conditional on being employed. The immediate fall in income resulting from unemployment is thus worsened by the loss in non-cash benefits such as employer-sponsored health. The loss of these benefits can be a particularly severe blow to middle- and low-income households.

…and retirement savings are eroded

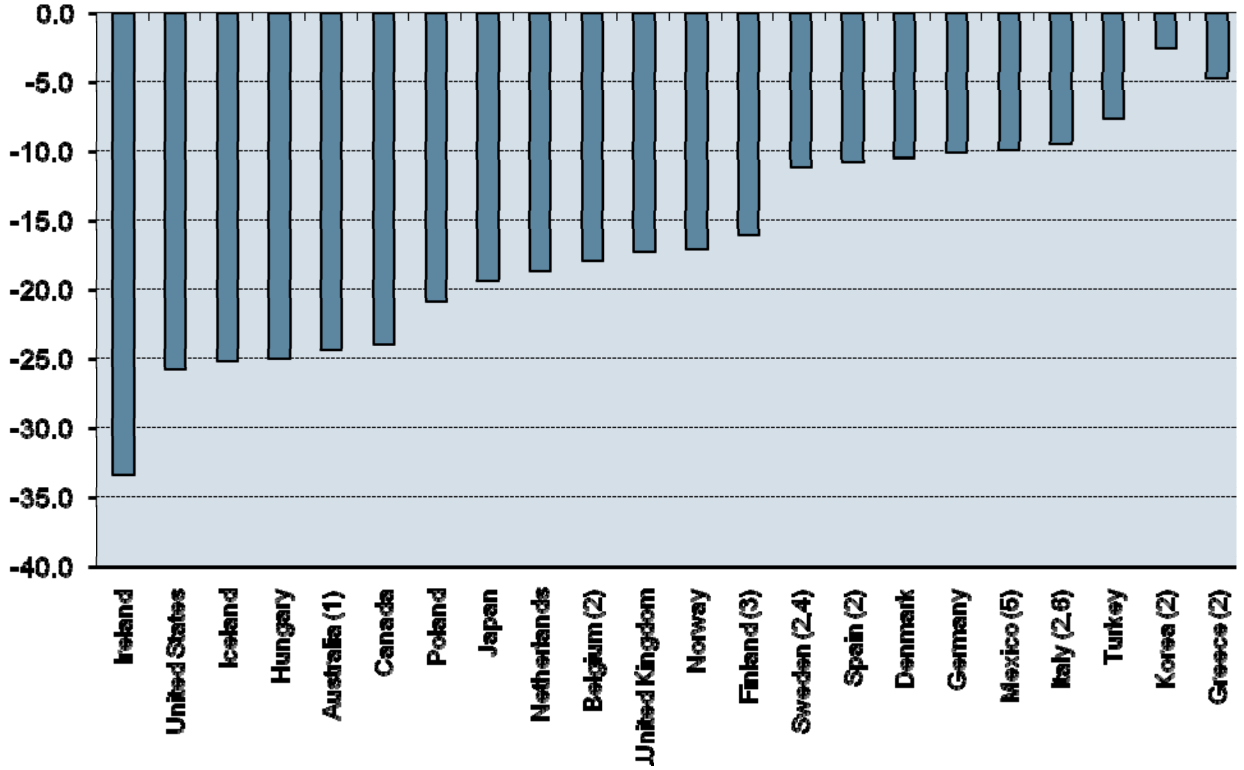
59. An immediate consequence of the collapse of stock markets in 2008 has been the dramatic decline in individual wealth held in pensions.[33] According to the OECD, between January and October of 2008, private pensions registered losses of nearly 20 per

[32] The generosity and replacement rates of unemployment benefits – an important consideration – vary significantly from country to country, and should not be taken as an indication as to the amount of money spent on non-work assistance. OECD: *Employment Outlook*, 2008; C. Stone; R. Greenstein; M. Coven: *Addressing Longstanding Gaps In Unemployment Insurance Coverage*, Center on Budget and Policy Priority, 2007; and OECD Database on Benefits and Wages.

[33] Losses in advanced economies approached 40 per cent in 2008. The MSCI Emerging Market Index (25 emerging country indices) lost more than half its value (54.5 per cent) over the same period – the worst annual performance since the measure was created two decades ago.

cent – representing a value of $4.5 trillion (Figure 6). This has prompted concerns about the adequacy of retirement savings for many individuals.

Figure 6. **Pension fund returns (real), for selected countries, January-October 2008 (percentages)**



(1) Official data up to June 2008 then complemented by OECD estimate up to October.
(2) 2008 data refer to 30 September 2008.
(3) Data refer to statutory earnings-related pension plans
(4) Data refer to occupational pension plans only.
(5) Data refer to the mandatory and voluntary pension systems.
(6) Data refer to new pension funds (contractual and open) instituted after 1993 legislation.

Source: OECD.

60. In World Bank client countries with funded pension systems, losses in pension funds range from 8 per cent to 50 per cent.[34] In Chile, for example, the private pension funds that cover 8.3 million workers lost a total of $25 billion in 2008. Traditional pension systems provided by governments on a pay-as-you-go basis will also be affected by the current downturn, but much less than private pension funds. Interestingly, in view of the pension crisis, the World Bank has shifted its stance on this matter and is now advocating greater focus on government-backed pay-as-you-go systems.[35]

[34] World Bank: *The Financial Crisis and Mandatory Pension Systems in Developing Countries*, 2009.
[35] *Ibid*.

These developments come on the heels of an expansionary period where the gains of growth were unevenly distributed

61. The global economic crisis comes after a sustained period of growth, whose benefits were unevenly shared.[36] During the two decades that preceded the crisis, the incomes of richer groups grew faster than those of middle- and low-income groups.[37] As mentioned in Box 1, growing income inequalities within countries contributed to an increase in the demand for credit, which, in conjunction with poor financial regulation, lies at the heart of the current crisis.

In sum, the risks of prolonged labour market and enduring social crises need to be averted

62. By definition, any financial crisis has serious consequences on the entire real economy, which depends so vitally on financial markets in order to grow and create jobs. But the current financial crisis is deeper than recent ones. It has its origins in developed countries which had been the engine of global demand and trade growth. In addition, given the strong international inter-linkages, it affects most countries. And, against the backdrop of the pre-crisis expansionary period, in which gains were unevenly shared, the economic and social costs of the crisis are noticeably widespread. Perceptions of unfairness are mounting, increasing the risk of social instability.

63. The challenge is to avoid a major labour market and social crisis. Already, job losses have mounted and new entrants like youth have had difficulty finding employment. However, the rise in unemployment has been contained to some extent as firms have attempted to limit the extent of layoffs via recourse to shorter hours and partial unemployment. This could change with a prolonged recession – in such an event, significant increases in unemployment would be unavoidable and, in developing countries, a long-lasting shift to informality and higher working-poverty would occur.

64. A prolonged recession would have deeper effects than just higher unemployment and increased informality and working-poverty. With so many people around the world lacking social protection, social hardship resulting from poor job prospects would intensify. Some developing countries will also need to integrate growing numbers of return migrant workers. And within countries the movement of workers from urban centres where jobs disappear, back to rural areas poses acute challenges as well. Social protection itself is being affected by the crisis, at the time when it is most needed, especially in countries that relied excessively on private pension funds or employer-provided health care.

[36] ILO: *World of Work Report. Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.
[37] *Ibid.* and ILO: *Global Wage Report*, Geneva, 2008.

II. International and country responses to the crisis

65. Given the grim economic outlook, and risk of widespread labour market and social consequences, countries around the world have adopted unprecedented measures to address the global economic slowdown. This section provides a brief overview of the outcomes of efforts to coordinate the measures among countries. It also describes rescue efforts undertaken by 40 countries (including the G20).[38] This includes an overview of the labour market initiatives that have been put in place, and the role of social dialogue and tripartite institutions in shaping the discourse to date.

International efforts to coordinate responses to the crisis have been stepped up

66. The global financial market has been unstable since as early as 2007. But 2008, marked by bankruptcies and bailouts of financial institutions (notably AIG, Bears Stearns and Lehman Brothers) placed the financial system in a state of constant turmoil and volatility. Credit markets froze and stock indices tumbled throughout 2008. The first round responses were largely uncoordinated, but the case for more internationally coordinated action has become increasingly clear – as witnessed by several efforts. These include:

- the G20 commitment at the meeting in Washington in November 2008, which prescribes action to be taken in key determinants of decent work and agrees on the importance of coordinating macro-economic policies and reducing global imbalances;
- an Economic Recovery Plan approved by the European Council in 2008 (200 billion euros), which aims to boost demand through joint fiscal stimulus action as well as temporary support for the unemployed through cash transfers and extension of unemployment benefits. It also calls for lower taxes and social contributions, and measures targeting small enterprises.[39]

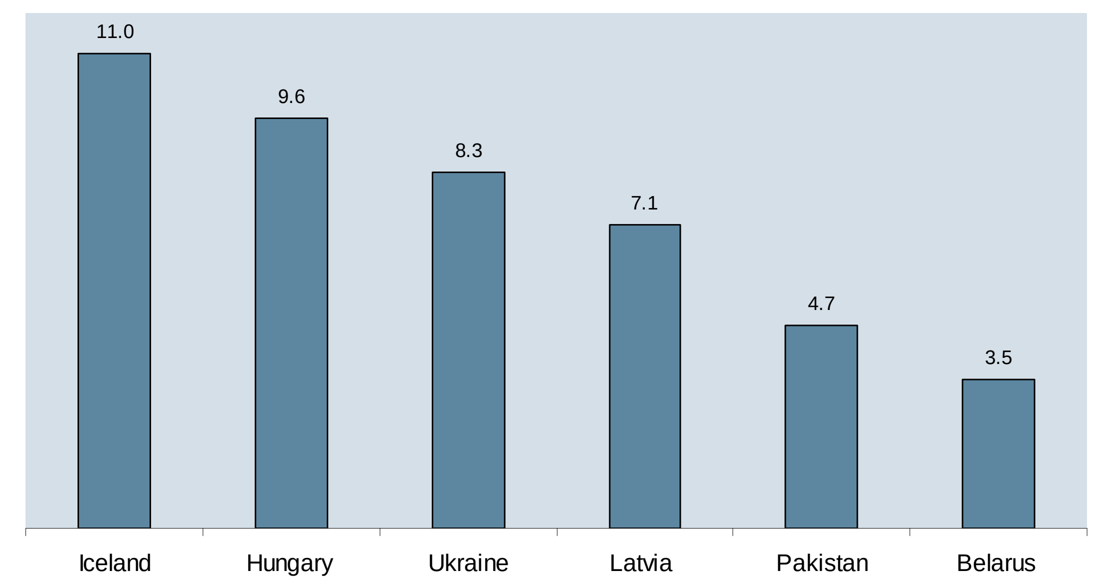
67. Addressing the social dimensions of the crisis is at the core of ILO's mandate. The Social Justice Declaration stresses that "As trade and financial policy both affect employment, it is the ILO's role to evaluate those employment effects to achieve its aim of placing employment at the heart of economic policies".

68. The IMF has provided financial assistance to countries affected by rapidly declining capital inflows, and balance of payments deficits. The policy response by most emerging economies facing such situations has generally involved pro-cyclical fiscal and monetary tightening designed to restore market confidence, combined with IMF interventions to

[38] For a detailed presentation of the measures, see S. Khatiwada: *Stimulus packages to counter the global slowdown*, IILS, ILO, forthcoming 2009.
[39] On 11 and 12 December 2008, the European Council approved a European Economic Recovery Plan, equivalent to about 1,5 per cent of the GDP of the European Union. The plan provides a common framework for the efforts made by Member States and by the institutions of the European Union.

bail out international creditors and investors.[40] Therefore, as part of the crisis resolution tools available for countries, the IMF has offered its fast-track emergency lending facilities. So far, the governments of Belarus, Hungary, Iceland, Latvia, Pakistan and Ukraine have resorted to IMF loans to restore their financial and economic systems (Figure 7). Latvia has a stand-by arrangement whereby IMF credits can be provided to finance a temporary balance of payments deficit. The IMF also has about $200 billion for immediate lending and can draw an additional $50 billion if needed.[41]

Figure 7. **IMF assistance as percentage of GDP**



Source: IMF.

Governments have provided prompt, massive support to rescue the financial system…

69. Government efforts to strengthen bank balance sheets were initially undertaken on a case-by-case basis. For example, the United States and European governments injected capital into individual banks or induced mergers in hopes of reviving the credit market by encouraging banks to lend to one another. But market confidence continued to decline and credit markets remained frozen, highlighting the need for system-wide intervention.

70. The system-wide interventions subsequently put in place by the United States and European governments have involved ensuring bank funding through explicit government guarantees on retail deposits and other bank liabilities, and reducing bank leverage through government purchases of distressed assets or capital injections. Almost all the major economies have increased guarantees of private deposits, put in place inter-bank loan guarantees, banned or restricted short-selling and injected capital into troubled banks by buying equity stakes (Table 2).

[40] Y. Akyüz: *From liberalization to investment and jobs: Lost in translation*, Policy Integration and Statistics Department, Working Paper No. 74, ILO, Geneva, 2006.
[41] As IMF Managing Director Dominique Strauss-Khan recently pointed out, the IMF may need another $150 billion to help counter the hit to emerging markets and poor countries. Japan has pledged $100 billion while other nations have yet to commit to help.

71. Australia, Canada, Germany, Norway, Spain, Switzerland and the United Kingdom have opted to buy (or insure) toxic assets, while the United States abandoned this plan in favour of direct capital injections. However, under the new administration, the United States is considering getting troubled assets off banks' balance sheets by using at least $500 billion (possibly up to $1 trillion) in private and government money. The three main elements of the new programmes proposed by the United States Treasury Secretary are: injecting government capital into the biggest financial institutions; establishing public-private partnership to buy banks' troubled assets; and starting a credit facility with the Federal Reserve with as much as $1 trillion to promote lending to consumers and businesses.

Table 2. **Crisis resolution instruments for select countries**[1]

	Increased guarantee of private deposits	Guarantees for bank loans or debt	Fund to purchase commercial papers	Purchase mortgage bonds	Ban or restrict short-selling[2]	Capital Injections	Option to purchase toxic assets	Induced Mergers & Acquisitions	IMF's emergency lending
Australia	X	X		X	X		X		
Austria	X	X			X	X			
Belgium	€ 100,000	X			X	X			
Brazil								X	
Canada		X		X	X		X		
China						X		X	
Denmark	X	X		X	X				
Finland	€ 50,000	X			X				
France	€ 70,000	X			X	X			
Germany	X	X			X	X	X		
Greece	€ 100,000	X			X	X			
Hungary	€ 50,000	X				X			$15.7 billion
Iceland	X					X			$2.1 billion
India						X			
Indonesia	2 billion rupiahs								
Ireland	€ 100,000	X				X			
Italy	€ 100,000				X	X			
Japan		X			X				
Korea	X	X				X			
Mexico		X							
Netherlands	€ 100,000	X			X	X			
New Zealand	X	X							
Norway	X	X					X		
Poland	€ 50,000								
Portugal	€ 100,000	X				X			
Russian Federation	X	X			X	X			
Spain	€ 100,000	X		X	X		X		
Sweden	€ 50,000	X		X		X			
Switzerland	X		X			X	X		
Turkey									X
United Kingdom	£50,000	X		X	X	X		X	
United States	$250,000	X	X	X	X	X	X	X	

(1) Most crisis resolution instruments were put in place in October-November, 2008; only the countries that instituted at least one measure are included. An "X" denotes some action taken by a country in the corresponding area.
(2) Ban on short-selling has been lifted for some asset classes in Switzerland and the UK.
Source: IILS based on Bloomberg, Bank for International Settlements and OECD.

…which has been supported by monetary easing and other actions of central banks

72. In addition, central banks around the world have taken action to address the challenges in the global financial market by means of providing liquidity and easing monetary conditions.[42] For example, the United States Federal Reserve Bank and other major central banks, including the European Central Bank, the Bank of England, and the Bank

[42] Quantitative easing involves increasing the base money stock by purchasing government securities and qualitative easing involves purchasing private securities, including possibly illiquid private securities and/or private securities subject to substantial default risk.

of Japan increased assets substantially in order to provide direct lending to banks and dealers through existing and new lending facilities.

73. In addition, aggressive monetary easing has been adopted in light of the rapidly deteriorating economic outlook, including a series of internationally-coordinated interest rate cuts (Table 3). This shift in focus of monetary policy from inflation targeting to supporting economic activity has been supported by a rapid decline in inflation, with some countries now facing deflation pressures. For example, the United States Federal Reserve cut its federal funds rate to a historically low level of between 0 and 0.25 per cent. Even among emerging economies, inflation fears have largely subsided with the rapid decline of commodity prices. However, despite these efforts, global economic activity has continued to decline and with rates at near-zero levels in some cases, further recourse to monetary policy is limited. Governments have thus turned their attention to fiscal rescue packages.

Table 3. **Monetary policy - interest rate changes**

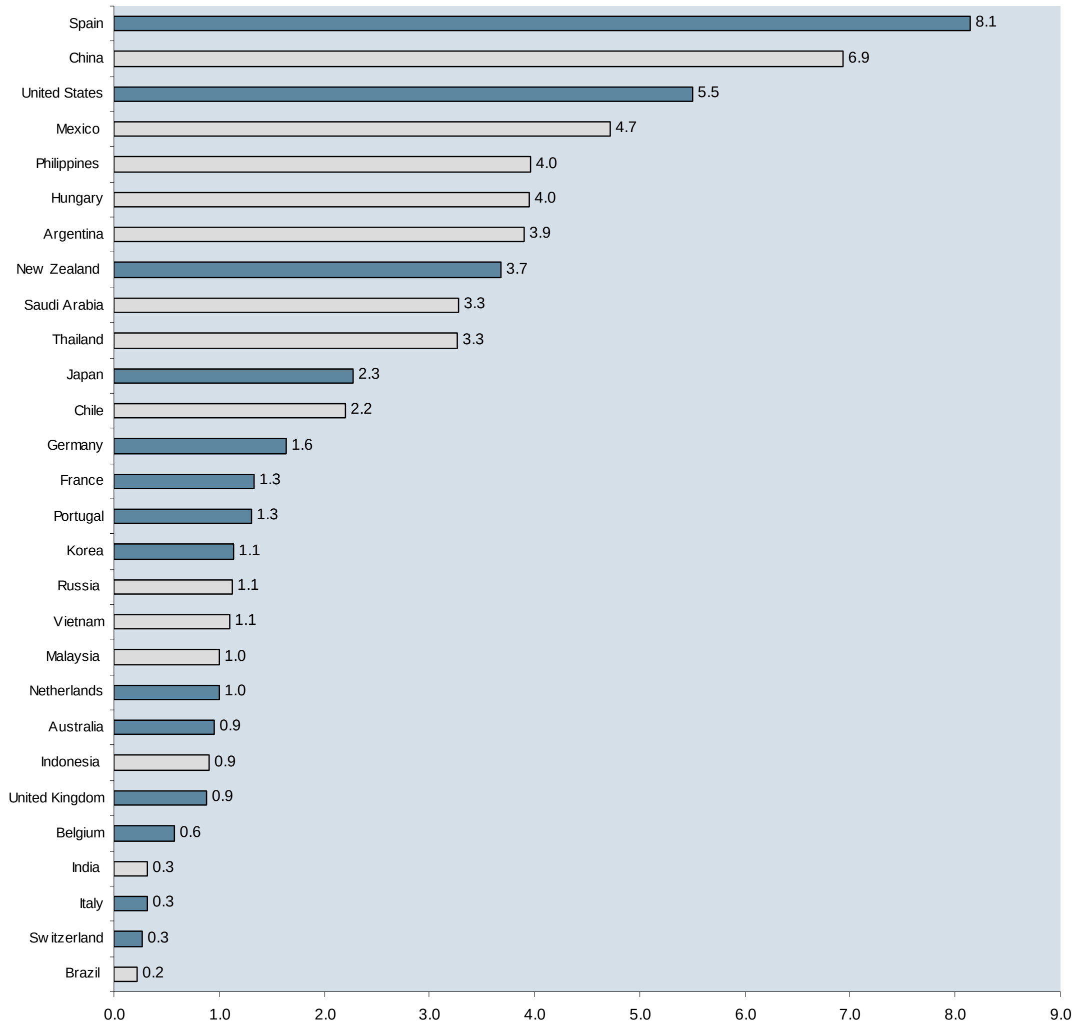
Australia	Cut to 3.25 per cent, February 2009	**Malaysia**	Cut by 0.75 per cent to 2.5 per cent, January 2009
Austria	Cut (ECB)[1]	**Mexico**	Cut by 1 per cent to 6.75 per cent, January 2009
Belgium	Cut (ECB)	**Netherlands**	Cut (ECB)
Brazil	Cut by 1 per cent to 12.75 per cent, January 2009	**New Zealand**	Cut by 1.5 per cent, December 2008
Canada	Cut by 2.25 per cent over 2008; cut by 0.5 per cent to 1 per cent, January 2009	**Nigeria**	Cut by 0.55 per cent to 9.7 per cent, September 2008
Chile	Cut the overnight lending rate by 1 per cent to 7.5 per cent, January 2009; cut by another 0.25 per cent to 7.25 per cent, January 2009	**Norway**	Cut
China	Cut one year lending rate by 1.89 per cent to 5.58 per cent, December 2008; cut by another 0.27 per cent to 5.31 per cent, December 2008	**Philippines**	Cut by 0.5 per cent to 5 per cent, January 2009
Denmark	Cut by 0.75 per cent to 4.25 per cent, December 2008	**Poland**	Cut
Finland	Cut (ECB)	**Portugal**	Cut (ECB)
France	Cut (ECB)		
Germany	Cut (ECB)	**Saudi Arabia**	Cut main repo rate by 0.5 per cent to 2.5 per cent, December 2008; cut by another 0.5 per cent to 2 per cent, January 2009
Greece	Cut (ECB)	**South Africa**	Cut main repo rate by 0.5 per cent to 11.5 per cent, December 2008
Hungary	Increase by 3 per cent, October 2008 (emergency measure); cut by 0.5 per cent to 10.5 per cent, December 2008; cut by another 0.5 per cent to 10 per cent, December 2008	**Spain**	Cut (ECB)
Iceland	Increase (emergency measure)	**Sweden**	Cut by 1.75 per cent, December 2008
India	Cut repo rate by 1.5 per cent to 7.5 per cent, October 2008; cut by 1 per cent to 6.5 per cent, December 2008; cut by another 1 per cent to 5.5 per cent, January 2009	**Switzerland**	Cut to 0.5 per cent, December 2008
Indonesia	Cut by 0.25 per cent to 9.25 per cent, December 2008; cut by 1.5 per cent to 8.75 per cent, January 2009; cut by 0.5 per cent to 8.25 per cent, February 2009	**Thailand**	Cut to 2 per cent, January 2009
Ireland	Cut (ECB)	**Turkey**	Cut to 13 per cent, January 2009
Italy	Cut (ECB)	**United Kingdom**	Cut by 1 per cent to 2 per cent, December 2008; cut by 0.5 per cent to 1.5 per cent, January 2009; cut by another 0.5 per cent to 1 per cent, February 2009
Japan	Cut by 0.2 per cent to 0.3 per cent, October 2008; cut by another 0.2 per cent to 0.1 per cent, December 2008	**United States**	Cut by 3.25 per cent from January to October 2008; cut to a range of 0.25 to 0 per cent, December 2008
Republic of Korea	Cut by 1 per cent to 3 per cent, December 2008; cut by another 1 per cent to 2 per cent, February 2009	**Vietnam**	Cut by 1.5 per cent to 7 per cent, January 2009

(1) The European Central Bank (ECB) rate stands at 2 per cent as of January 2009.
Source: IILS, based on national sources.

Fiscal stimulus packages have been announced, though with a delay vis-à-vis financial rescue measures…

74. As the G20 Summit in Washington underscored, there is a growing consensus that aggressive fiscal measures – cutting taxes and boosting spending – are required to stimulate domestic demand and avert the worst economic slump since the Great Depression. As a result, countries have announced fiscal rescue packages of varying sizes, with Spain announcing the biggest package as a percentage of GDP, followed by China and the United States (Figure 8).

Figure 8. **Fiscal package as a percentage of GDP (as of February 2009)***



* 2008 GDP from IMF World Economic Outlook. Developed economies are indicated in dark; developing and emerging economies, in gray. Time frame of spending is not clear for most countries and in some cases, package was announced but not the details. For China, Germany and the United Kingdom, the time frame is 2 years, hence the total package was divided by 2.

Source: IILS, based on national sources.

… a degree of uncertainty regarding the precise size and timing of the package…

75. However, there are uncertainties regarding the exact size and timing of the stimulus packages. First, the breakdown of rescue efforts in terms of old spending (already in the pipeline) and new spending is uncertain. Second, the time-horizon in which the stimulus package will be administered is also unclear. For some countries like China, Germany and the United Kingdom, the time frame is two years (2009-10), but for most countries, the time frame of new spending measures has not been decided as yet.[43] Third, most countries have announced fiscal rescue packages different from their financial rescue packages, but there is a tendency to count in financial help to different sectors (like loan guarantees) as part of the package. For the countries examined here, an attempt has been made to disentangle fiscal efforts from financial efforts. And fourth, some countries have

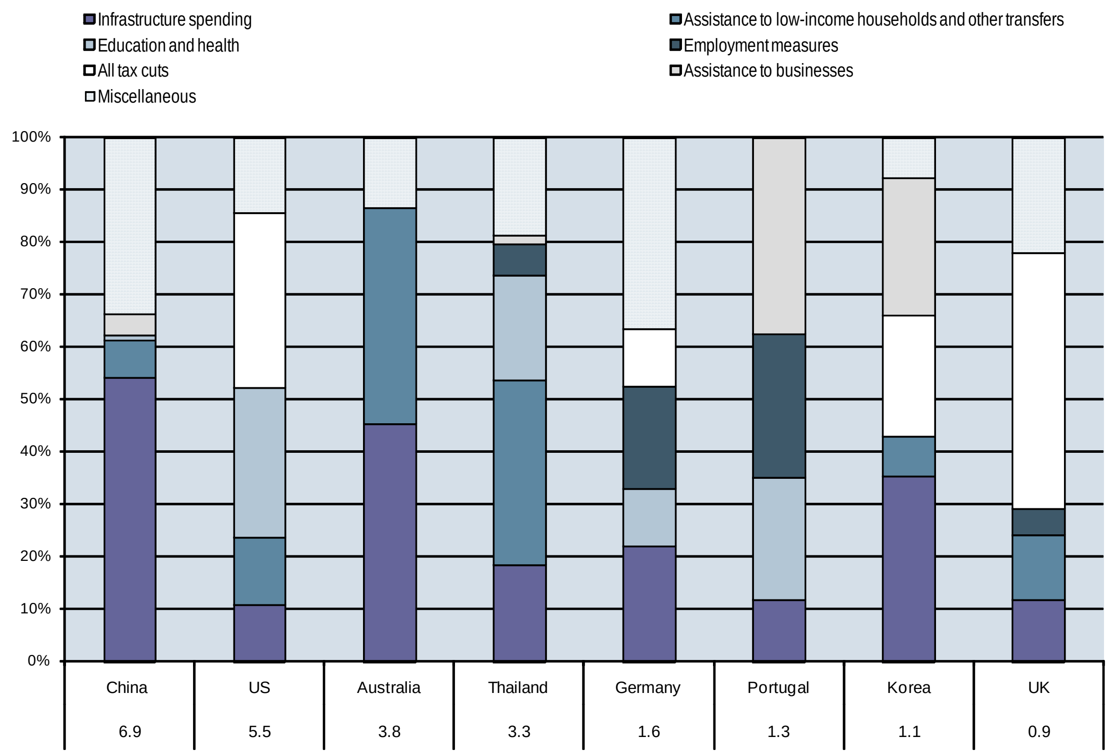
[43] The total rescue package for the China, Germany and the United Kingdom is divided by two before calculating the package as a percentage of GDP.

announced stimulus spending embedded in their annual budgets, which makes it difficult to identify the size of new spending.

... and significant variation in the composition of spending efforts…

76. Across a range of 8 countries with detailed available data, there is significant variation in terms of the emphasis placed on different components of the stimulus package (Figure 9). All, however, have dedicated resources to infrastructure spending, though the share ranges from over half (54 per cent) in China to as low as 11 per cent in the United States. On the other hand, the degree of employment measures and support to low-income households is generally limited. For example, only half the countries have implemented employment measures (notably Germany and Portugal) and only Australia and Thailand dedicate significant resources to low-income households.

Figure 9. **Composition of spending as a percentage of total for selected countries**



* Countries are organized by rescue package as a percentage of GDP.
Source: IILS, based on Bloomberg, Asian Development Bank, and New York Times.

77. A broader analysis of the 40 countries with available data confirms that the composition of rescue packages varies considerably, but almost all the rescue efforts can be divided into three main areas: increase spending on public goods and services, fiscal stimulus aimed at consumers (*e.g.* personal income tax cuts, cash transfers), and fiscal stimulus aimed at firms (*e.g.* corporate tax cuts).

78. In terms of *spending on public goods and services*:

- At least half the countries have announced spending increases in infrastructure and on education and health. The former focus on building and repair of roads, bridges, railway lines, and rural infrastructure projects with attention given to projects in the pipeline (*e.g.* China, Italy, and the Netherlands). Others like China, Japan, Portugal, and the United States have announced investment in energy efficient projects as part of infrastructure investments. China and Thailand have also announced measures to increase home availability (through public housing projects) for poor households.

- In terms of education and health, China and Saudi Arabia have announced significant increases in education and health spending with some school and hospital constructions as part of rural development programmes for several countries.

79. In terms of *fiscal stimulus aimed at consumers*:

- Germany, New Zealand, Russian Federation, Spain, the United Kingdom, and the United States are some of the many countries that opted for tax cuts aimed at stimulating consumer spending (these tax cuts fall into two categories: income tax cuts and sales tax cuts such as VAT reductions). Others have adopted tax cuts to boost sales in certain sectors, such as automobiles in Brazil, Germany and Turkey.
- Australia, Italy, Mexico and the United States have put in place measures to help home buyers. In some cases, this includes incentives for consumers to purchase energy efficient homes and "greening" existing homes by providing subsidies and tax exemptions.
- Australia, China, France, Indonesia, Italy, Japan, Mexico, Philippines, Spain, and the United States have announced increases in social transfers aimed at poor and low-income households. Social transfers include direct cash transfers, conditional cash transfers, and social welfare programmes.

80. In terms of *fiscal stimulus aimed at firms*:

- Several stimulus packages have placed emphasis on the viability of large firms, especially in the financial and automotive sectors.
- In some cases, measures have been explicitly targeted at SMEs (e.g. Japan, the Republic of Korea, and Mexico). In addition, public investments in infrastructure, construction and housing will also provide new market opportunities for SMEs. Other measures to firms have been specifically targeted to mitigate the impact on employment.

... and varying degrees of direct support for employment and social protection…

81. Some countries have announced explicit measures to help workers and employers as part of their fiscal rescue efforts (see some country examples in Table 4):

- Japan and the United States have put in place extension of unemployment benefits. France and Switzerland have also put in place more generous systems of unemployment benefits for temporarily laid-off workers. Meanwhile, Canada, China, and Turkey are in the process of extending unemployment benefits. Other countries like Korea, Philippines, and Thailand have announced country-specific measures to assist vulnerable workers.
- Some countries are making greater use of in-work benefits in conjunction with reduced working hours to curtail layoffs. For example, in Germany, the government extended the possibility for workers who continue to be employed – but at reduced working hours – to receive income supplements, and companies are reimbursed 100

per cent of their social security contributions on behalf of employees when the down time (i.e. reduced working hours) is used for training.

- To encourage hiring, some countries have announced subsidies and exemptions. For example, the United Kingdom has announced subsidies for employers (up to £2,500) who hire workers who have been unemployed for more than six months, and Japan has announced subsidies for employers who hire temporary workers as regular employees. Other countries that have announced some sort of hiring incentives include Australia, Chile, China, France, Germany, Korea, the Netherlands, and the United States.
- Australia, Canada, Chile, China, France, Germany, Indonesia, Japan, Korea, Portugal, Thailand, the United Kingdom and the United States have announced training programmes for laid-off workers as part of their labour market initiatives. Training programmes include, among others, vocational workshops for laid-off migrant workers, and expanded opportunities for apprentices in trades.
- It is also likely that the new infrastructure projects, discussed briefly above, and increased funding for local governments will result in more public sector jobs. As of February 2009, some 20 countries of the 40 have made such announcements.

82. A few countries have announced *explicit goals for job creation*. These include Chile (100,000), France (80,000 to 110,000), Hungary (20,000), Indonesia (2.6 million), Spain (300,000) and the United States (3.5 million). In France, Spain and the United States, job goals include the creation of green jobs. However, the goals for job creation do not include plans to save existing jobs.

Table 4. **Examples of labour market initiatives in response to the crisis**[1]

	I. Extension of unemployment benefits	**II. Activation measures**		**III. Increase in public sector jobs**[3]
		A. Hiring incentives for employers[2]	**B. Other activation measures (job-search help, training, measures targeted at disadvantaged group, etc.)**	
Argentina				X
Australia		Funds to employers for staff development and training programs	Increase in productivity training places from 57,000 to 113,000	X
Brazil	Increase in minimum wage by 12 per cent as of February 2009, which will affect 45 million workers; expansion of UE benefits from 3 to 5 months to 5 to 7 months			
Canada	X (ongoing discussions but not approved)		$1.5 billion in training fund for laid-off workers	
Chile		X		X
China	X (ongoing discussions at the local and regional level; recommended by the central government)	Reduction in medical and accident insurance premiums; flexible working hours and pay for service sector firms	Nationwide vocational training program for migrant workers returning home after losing jobs	A temporary moratorium on firing in state owned enterprises
France		Employers with less than 10 employees will not pay social taxes for each new employee they hire in 2009.	X	X
Germany	X	Reduction in health insurance contribution	X	
India				X
Indonesia			Job training; voluntary transmigration programs for laid off workers to areas less affected by the crisis	X
Italy				X
Japan	X	Increased subsidies for SME employers; subsidies for employers who hire temporary workers as regular employees	Support for non-regular workers in job-placement	Financial support to local governments that hire job-seekers
Korea	Support vulnerable workers (outside the boundaries of a social safety net) who are put on unpaid temporarily leave	Tax exemption and extension on tax submission periods for employers that maintain their workforce	X	X
Malaysia			Training for retrenched workers; re-training unemployed graduates over the next 2 to 3 years	
Mexico			Increase in seasonal employment programme	
Netherlands		Subsidies for company payrolls		X
Philippines	Increase in conditional cash transfers			
Portugal			€580 million in employment programmes	X
Saudi Arabia				X
Spain				X
Thailand	Cost of living alleviation projects and sustenance allowance		Capacity building for the unemployed	X
Turkey	X (proposed but not approved)			
United Kingdom		Subsidies for employers (up to £2,500) who hire workers that have been unemployed for more than 6 months	X	X
United States	Extension of unemployment benefits; health insurance for those who lost their job; increase in food stamps; increase in social security benefits	X	X	X
Vietnam	New unemployment insurance started in January 2009			X

1. This table includes only the explicitly announced measures. An "X" denotes some action taken by a country.

2. Corporate tax cuts are not counted as an incentive for employers to hire, nor are sectoral subsidies.
3. All the countries with increased spending in infrastructure projects are counted, as they increase public sector employment.
Source: IILS, based on national sources.

…with some efforts to engage social partners

83. In the early stages of the crisis, social partners in many countries had limited involvement in the design and implementation of government anti-crisis measures.[44] More recently, in some cases, social dialogue has been at the heart of governments' plan to address the economic slowdown. These include:

    - In Ireland, an agreement was signed between the government and the social partners, following a discussion of the government's recommendations for sustainable economic renewal. The agreement covers issues of pay growth, employment rights of temporary workers, and voluntary arbitration, among others.

    - In Pakistan, the tripartite Labour Conference was addressed by the Prime Minister, who announced a new era of consultations with social partners, and modernization of the country's labour law in cooperation with the ILO and the WTO.

84. In some cases, agreements arising from social dialogue initiatives have been embodied into law, such as the decree on partial unemployment benefits in France. Other countries such as Germany have passed a second economic stimulus package following extended consultations with national employers and workers' organizations. In the Russian Federation, the national tripartite commission dealt with the social impact of the crisis several times since October 2008. In some countries, these bipartite or tripartite consultations and negotiations went beyond the scope of narrowly defined labour issues, but also dealt with state budgets and larger economic and policy matters.

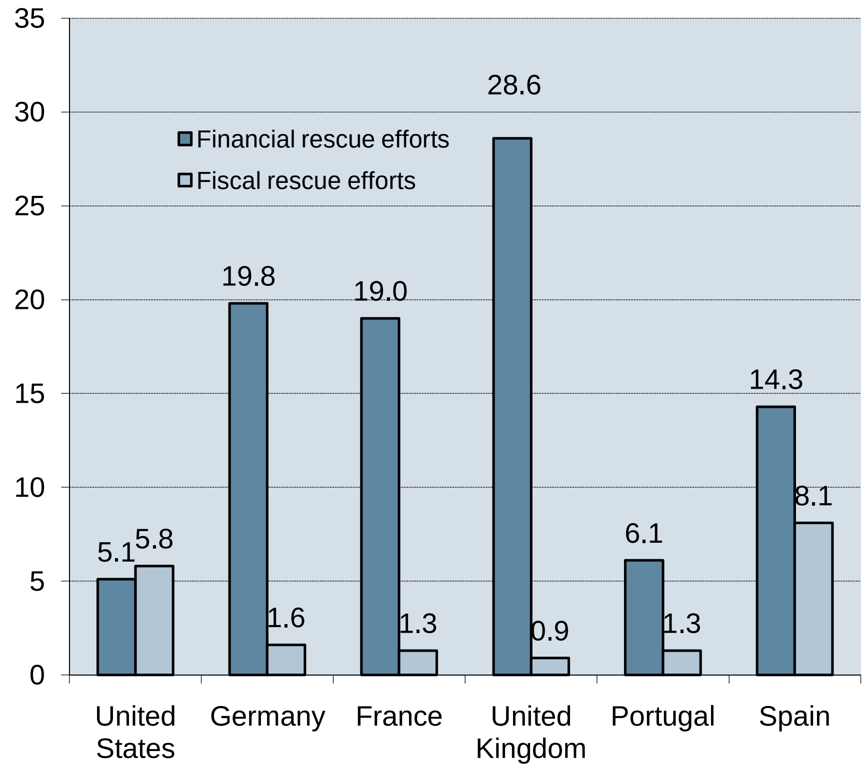
In sum, action has been swift, but relatively misaligned

85. There has been considerable emphasis on rescuing the financial sector. As Figure 10 shows, the amount spent on financial rescue efforts far surpasses fiscal rescue efforts for all countries except the United States.[45] Indeed, protecting banks' solvency and restoring the availability of credit to enterprises and households was rightly regarded as a pre-condition to avoid a total collapse of the financial system, with unpredictable consequences for the real economy. Governments have also announced fiscal stimulus measures – an important step in the right direction.

[44] L. Rychly: *Social dialogue on the design and implementation of measures in times of global financial and economic crisis*, ILO, forthcoming 2009.
[45] True, from an accounting point of view, financial rescue packages may not have any impact on the current net debt or budget balance. Measures like capital injection, if treated like a financial transaction, where the government receives in return a financial asset of equal value to the payment, would not affect the budget balance. In fact, the government could theoretically earn income once the markets return to normalcy. Furthermore, buying troubled assets could also prove to be profitable if the government manages to sell them at a higher value. And finally, loan guarantees are not exactly fiscal costs because they might never be exercised or used. Nevertheless, while it is true that comparison between financial and fiscal rescue efforts as a percentage of GDP should not be taken literally, it is very likely that governments will incur costs in rescuing the financial sector which will be far greater than the costs of the fiscal rescue efforts.

86. But there is much debate regarding the desirable content of the packages, their timing, and whether some of the measures should be merely temporary – as championed by the "3 t" approach – or rather, more enduring.[46] The next section addresses these issues.

Figure 10. **Comparison between fiscal and financial rescue efforts as a percentage of GDP**



Source: IILS, based on ILO, OECD & Bloomberg.

[46] According to the "3t" approach, governments should intervene to address the crisis. But interventions should be timely, targeted and – in particular – temporary. The latter means that deviation from market principles should be provisional. Once the economy recovers from the crisis, the state should phase out the measures as quickly as possible.

III. Decent Work as cornerstone of the recovery: A global jobs pact

87. A global jobs pact would be instrumental in overcoming the crisis and paving the way for a more sustainable economy. A *global* approach is needed because the measures, to be effective, need to be coordinated across countries. The emphasis on *jobs* comes from the realization that decent work is central to reactivating the economy in a sustainable manner. This builds on ILO experience with the Global Employment Agenda.[47] Measures are best implemented through social dialogue at the national level, but greater cooperation at the international level can also have mutually reinforcing benefits – thus the need for a *pact*. In this respect, building upon the lessons of the past and avoiding counterproductive measures, such as trade protectionism and generalized wage deflation, will also prove invaluable.

88. More specifically, by putting the Decent Work Agenda at the forefront, a global jobs pact could ensure that stimulus measures more effectively tackle the transmission mechanisms of the crisis, namely the credit crunch, the rapid deterioration in domestic demand conditions and the recession in external markets. A global jobs pact could also address the key factors that nurtured the crisis and lay the foundation for a more sustainable economy.

Reviving the credit system and providing targeted support to sustainable enterprises

89. Experience from previous financial crises suggests that adopting stimulus packages without reviving the credit system may end up raising public debt without stimulating the economy and creating jobs.[48] Furthermore, it has been shown that countries can incur significant fiscal costs because of their failure to tackle problems in the financial system in a timely manner.[49] In light of these lessons, successfully stimulating economic activity will require reactivating credit markets, thus helping businesses to remain viable and be in a position to respond to well-designed fiscal stimulus programmes. A well-functioning financial system is essential for a growing and dynamic private sector. Easier access for SMEs, including cooperatives and start-ups, to financing (such as credit, leasing, venture capital funds or similar or new types of instruments), creates appropriate conditions for a more inclusive process of enterprise development. Financial institutions, particularly

[47] See GB.286/ESP/1(Rev.) and GB.300/ESP/2. Moreover, since 2000, the International Labour Conference has adopted conclusions concerning the following employment themes: decent work and the informal economy (2002); youth employment (2005); the promotion of sustainable enterprises (2007); skills for improved productivity, employment growth and development (2008); and promotion of rural employment for poverty reduction (2008).
[48] The Japanese financial crisis during the 1990s, and the debate about the "lost decade", is a case in point.
[49] C. Reinhart; K. Rogoff: *The Aftermath of Financial Crises*, paper prepared for presentation at the American Economic Association, 2008.

multilateral and international ones, should be encouraged to include decent work in their lending practices.[50]

Re-activating credit to stimulate the real economy …

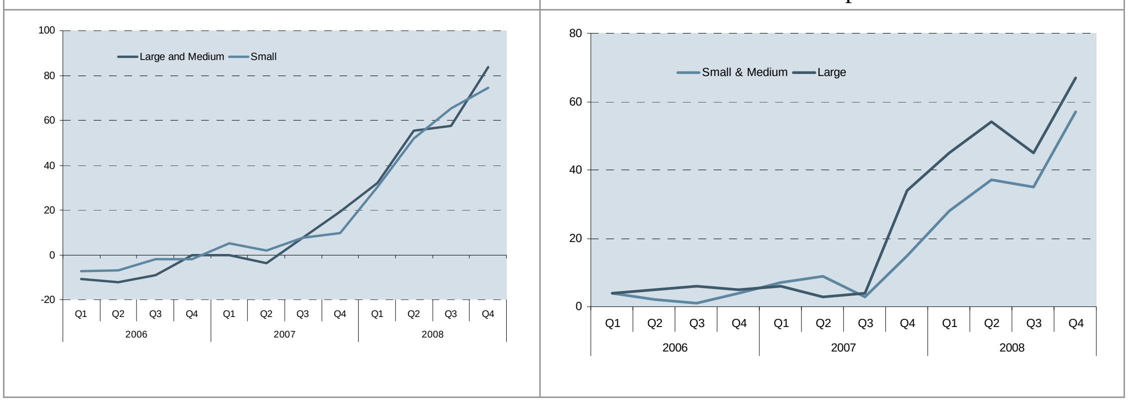
90. Despite the large-scale financial rescue measures, there are indications that banks are reluctant to lend. In the EU and the United States, lending standards have tightened considerably (Figure 11). As a result, individuals and firms have delayed investment decisions, constraining future economic growth and job creation.[51]

91. One factor is that government conditions for support to banks have thus far been weak. Even in countries where banks receiving government support are required to make credit available to businesses, there are no sanctions or penalties for institutions that fail to comply. Banks continue to undergo the process of "deleveraging", i.e. the amount of capital available to the real economy is restricted by banks' efforts to improve their balance sheets and reduce the burden of "toxic assets".[52]

92. Interestingly, in the United States, state-owned banks have shown greater readiness to lend to businesses and consumers than their private-sector counterparts. This might reflect more limited exposure to risky financial operations among state-owned banks. But the fact that these banks are directly accountable to the government may have contributed as well.[53]

Figure 11. Percentage of lenders tightening standards, by size of enterprise seeking loans

Panel A: United States | Panel B: European Union



Source: US Federal Reserve; ECB.

…with targeted support to SMEs …

93. Tighter lending standards present particular challenges for SMEs given their reliance on bank credits – they do not have access to capital markets in the same way larger firms

[50] ILO: Conclusions concerning the promotion of sustainable enterprises, International Labour Conference, Geneva, June 2007, para. 11.
[51] A prolonged investment slump would entail lower capital accumulation, thus reducing productivity gains and limiting the scope for improved living standards in the long-run.
[52] As illustrated in Section II, some government efforts have attempted to address this directly by purchasing or insuring toxic assets in the hopes of improving the lending situation.
[53] Cooperative banks have reportedly pursued their regular lending operations as well (see H. Hagen, 2009, forthcoming).

do. This is why restoring credit conditions in general will have especially favourable effects on small businesses. In the meantime, measures such as special credit lines and direct access to government loans could be envisioned for SMEs to assist them in gaining access to capital.

94. This will be key if SMEs, which account for up to 95 per cent of enterprises and are responsible for most existing and new jobs, are to take advantage of new opportunities that arise from the public investments in infrastructure, construction and housing. The ILO's Small Enterprise Development Programme can play a helpful role in this respect (Box 5).

Box 5. ILO's Small Enterprise Development Programme

The ILO's Small Enterprise Development Programme provides policy advice and support to SMEs in clusters and value chains, particularly those with job creation potential, to improve quality and productivity by enhancing good workplace practices and management-labour collaboration.

The programme also aims to maximize SME involvement in public procurement programmes. For instance, the programme has been assisting governments to administer and supervise contracts for local contractors and training local contractors to tender and deliver such contracts. Such activities are helpful complements to infrastructure programmes carried out as part of the response to the crisis.

Another role of the programme is to assist national and local governments in reviewing and improving the regulatory environment for SMEs. This too can be instrumental in times of crisis.

...and viable sectors through social and "green" conditionality, not protectionism

95. As noted in the first section of this paper, the crisis is hitting certain sectors harder than others. Export-oriented sectors are particularly vulnerable to both the credit squeeze, given their reliance on trade finance, and the spectacular fall in world demand and commodity prices.

96. Governments are thus under growing pressure to provide assistance to these sectors. Some countries have already increased import duties on automobile parts or steel. Others have imposed caps on imports of certain products, like chemicals or wood. Yet others have added "buy national" provisions in their fiscal stimulus plans. These types of measures can incite other countries to retaliate, or adopt counterbalance measures. Moreover, history shows that in the long-run protectionist measures are likely to create more substantial employment and income losses.

97. Instead, there are ways to support the long-run viability of industries by, for example, re-orienting them towards greener technologies that would: help stimulate economic activity by facilitating industrial restructuring; support sustainable employment creation; and prepare for the transition to a less CO2-intensive economy. One way to achieve this would be to provide assistance to certain sectors conditional on social and environmental

objectives.[54] The importance of synergies between investments in clean technologies and job creation has been recognized at the international level through the creation of the Green Jobs Initiative. The ILO has an important role to play in this initiative, along with its partners (United Nations Environment Programme, the International Trade Union Confederation and the International Organization of Employers) to ensure that green jobs become a positive driver of development in an environmentally, socially, and economically sustainable future (see also the last section of this paper).[55]

Boosting the economy through employment-oriented, coordinated actions

98. Despite the numerous stimulus packages introduced to date, aggregate demand continues to worsen. As noted above, part of the problem may be that efforts to address the challenges have been insufficient in magnitude. In fact, some of the "new" public spending is a repackaging of previously committed funds. Countries are reluctant to announce bold measures however because they are worried they will "leak" into the economies of their trading partners – a situation that is exacerbated, in some cases, by already deteriorating fiscal positions. This underlines the importance of measures that are coordinated across countries.

Stimulus packages need to be timely and better coordinated…

99. The complexities of the decision-making process may delay the adoption of stimulus packages. However, if unduly delayed, measures may come at a time when the recession is well underway and packages may prove insufficient or ill-adapted to the evolving circumstances. Success in overcoming earlier financial crises in Korea and Sweden is associated with the prompt adoption of a stimulus package. According to a simulation developed for the purpose of this paper, and assuming that credit markets were restored, it would take one year for the United States economy to recover if the "Obama package" was implemented now. And, according to the estimates, it would take almost two years if implementation of the package were delayed by three months.[56]

100. Better coordination of fiscal stimulus packages could also enhance the impact on global demand. There are cross-border externalities to the financial and fiscal rescue packages. Capital injections by the United States authorities would help alleviate the European financial crisis and vice versa. Likewise, a fiscal stimulus put forward by the Chinese government helps its trading partners and vice versa. Coordination is especially important in countries where fiscal space is limited as in the case of many African countries. In the absence of coordination in their response, these countries may be tempted to engage in a process of competitive devaluations or, worse, wage deflation. Coordinated action will also help boost world demand, hence cushioning the effects of a global recession.

[54] For example, France's plan to support its auto industry includes requirements that funding be used to invest in green technologies and that no layoffs would occur in 2009.

[55] ILO: "Green Jobs Initiative", available at http://www.ilo.org/integration/greenjobs.

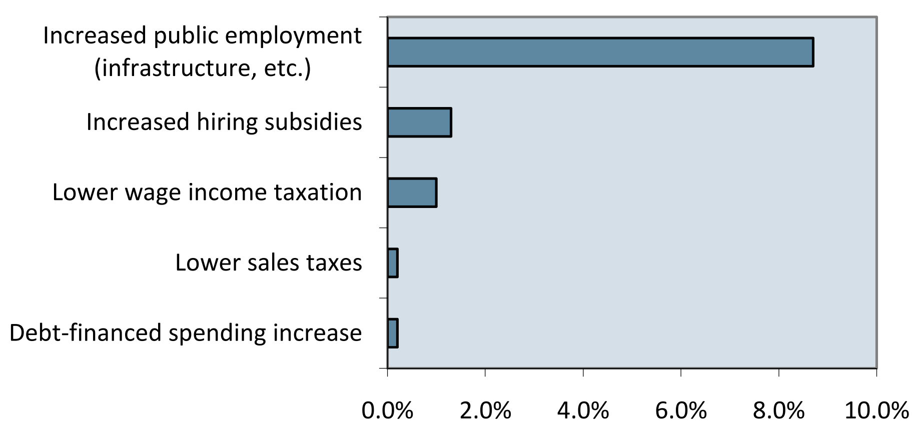
56 E. Ernst; M. Charpe: *Global economic linkages: Labour market implications of macroeconomic and social policies in open economies*, IILS, ILO, forthcoming 2009.

...with a strong focus on employment…

101. One of the lessons of the analysis carried out for this paper is that the greater the employment orientation of the measures, the stronger the stimulus for the real economy. As shown in figure 12, measures that have a direct impact on employment have a stronger effect than relatively untargeted measures (such as VAT cuts, or across-the-board spending increases).

102. In particular, the multiplier effects of investments in employment-intensive areas will be higher than is the case with alternate measures such as tax cuts.[57] At times of crisis, when there is considerable labour market slack, job-rich investment can crowd-in private sector activities and, more fundamentally, unlock development potential and pave the way for higher long-term growth. In this regard, public investments in infrastructure and agricultural development represent a major opportunity to address both employment and development challenges. These can include, among other things, investments in roads and communication, flood control and public buildings for education. To effectively lead to higher employment however, infrastructure projects need to meet existing domestic supply and skills.

Figure 12. Estimated employment effects of different fiscal measures*



* The figure shows the estimated employment effects of different fiscal measures. Each measure represents the equivalent of 5.7 per cent of GDP – the size of the stimulus package recently-adopted in the United States. For instance, it shows that employment would increase by up to 8 per cent in the long-run, if the entire package focused on public employment programmes such as infrastructure spending. Importantly, the estimates assume that new hires have the skills to perform the jobs created by the programmes. They also assume that sufficient domestic supply is available to respond to government incentives.

Source: IILS estimates.

57 A. Spilimbergo; S. Symansky; O. Blanchard; C. Cottarelli: *Fiscal Policy for the Crisis*, IMF Staff Position Note, IMF, 29 December 2008 (SPN/08/01). Stimulus aimed at consumers is potentially uncertain and limited, and direct subsidies to domestic firms have international trade law consequences and could lead to an uneven playing field and even trade wars (*ibid*).

103. Employment guarantees are another employment-intensive measure which, as experience from earlier crises shows, can be especially cost-effective in the face of the crisis – if well-designed and targeted:[58]

- Argentina's *Jefes y Jefas de Hogar Desocupados* programme, introduced during the 2001 crisis, reduced aggregate unemployment by an estimated 2.5 percentage points, increased labour force participation and reduced extreme poverty.59
- Similar pubic works programmes in Indonesia, Republic of Korea and Thailand adopted after the East Asian financial crisis, proved to be relatively successful in employing large numbers of individuals. However, studies suggest that programmes could have been more effective if better designed and monitored.60
- The National Rural Employment Guarantee (NREG) of India provides an important safety net for many rural households. The programme aims to provide additional employment to the underemployed and the unemployed by entitling every rural Indian household to 100 days of work per year. The budget for the NREG in 2006-07 was 0.33 per cent of GDP.61

104. In developed countries where most of the jobs are formal, supporting employment through partial unemployment benefits or subsidies for shorter working hours can prove effective. Such measures are being used extensively in some European countries. (see also Box 10 below for examples of experiences during the Asian financial crisis).

…supported by efforts to promote workers' skills...

105. To be successful, employment-intensive investments need to go hand-in-hand with efforts to promote skills development. In many cases, new skills will be needed in order to match the requirements of new infrastructure spending and programmes designed to support sectoral transition, e.g. towards greener technologies. In this regard, the design of such programmes is fundamental to ensure success due to the time required to adjust training provisions accordingly. Implementing time- and cost-efficient methods to identify current and future skills demands become crucial. The conclusions of the 2008 International Labour Conference discussion on Skills for improved productivity, employment growth and development can help in this regard.

[58] G. Márquez: *Labor Markets and Income Support: What Did We Learn From the Crises?*, Working Paper No. 425, Inter-American Development Bank, 2000; B. Cook: *Active Labour Market Policies in the Neo-Liberal Era*, Working Paper No. 08-03, Centre of Full Employment and Equity, 2008. Wage levels are very important in ensuring successful employment guarantees and public works. If wages are too high, they will distort the labour market and pull individuals (particularly the non-poor) from employment. High wages will also put pressure on programme funding and likely result in the rationing of jobs. On the other hand, if wages are too low, programmes will not be an effective safety net for participants and may become stigmatizing.

[59] E. Galasso; M. Ravallion: "Social protection in a crisis: Argentina's plan *Jefes y Jefas*", in *The World Bank Economic Review*, Vol. 18, No. 3, 2004, pp. 367-399.

[60] G. Betcherman; R. Islam, *East Asian labor markets and the economic crisis: Impacts, responses and lessons*, World Bank and ILO, 2001.

[61] P. Chakraborty: *Implementation of the National Rural Employment Guarantee Act in India: Spatial Dimensions and Fiscal Implications*, The Levy Economics Institute of Bard College, Working Paper No.505, 2007.

…and help jobseekers through effective public employment services and active labour market programmes

106. Active labour market programmes play an important role in skills development and more broadly in facilitating the adjustment of individuals to changing labour market conditions. Such programmes can take many forms, including: job-search assistance and monitoring, personalized action plans for job seekers, training, and targeted programs for disadvantaged groups. They can also provide much needed income support. If properly designed, they can enhance employability and improve labour market mobility in the short term. They can further facilitate matches between the skills of displaced workers and the skills required in the jobs created by new public investment (e.g. in construction, infrastructure and alternative energy).

107. Some lessons learned to date about enhancing the effectiveness of active labour market programmes include: an obligation on the part of the benefit recipient to undertake an activity and enforcement of this obligation by the programme; making participation in programmes compulsory; targeting increased effectiveness of outcomes, programmes and services (e.g. combining training and job-search assistance); and in-work benefits help facilitate a return to work.[62]

108. During a crisis, special programmes to assist displaced or retrenched workers should be intensified. The ILO *Guide to Worker Displacement: Some tools for reducing the impact on workers, communities and enterprises* demonstrates the wide range of possible responses by enterprises, communities and workers to economic downturns and how to reduce potential job losses. Schemes targeting temporarily laid-off workers can be very efficient, since workers with firm-specific training are often expected to return to work at the same firm (or sector) when the business climate improves. This type of programme could complement the employment-intensive public investments and initiatives to extend, or enhance, unemployment benefit coverage. This may mean allocating additional resources to public employment services. Already, some national employment services have been mobilized to help address the global economic crisis (Box 6).

Box 6. Enhancing public employment services and active labour market programmes

France: *Pôle Emploi*, the newly created agency that merges employment services and unemployment insurance, is increasing the resources available to enhance employment services, facilitate training for jobseekers and support the effort of social partners to coordinate measures to address the financial crisis.
Mexico: the *BÉCATE* programme of the National Employment Service is being expanded to provide various training programmes, including apprenticeships, which include monthly financial support for trainees and counselling on how to start a business.
Philippines: *Public Employment Service Offices* (PESOs) have been mobilized to intensify job placement, emergency employment and livelihood formation services, particularly for workers in commodity and export industries.

[62] See for example, OECD: *Employment Outlook*, Paris, 2005; M. Rosholm; M. Svarer: *Estimating the Threat Effect of Active Labour Market Programs*, Discussion Paper No. 1300, Institute for the Study of Labor, 2004; M. White; R. Riley: *Findings from the Macro Evaluation of the New Deal for Young People*, DWP Research Report No. 166, Centre for Development Studies, University of Leeds, 2002.

Republic of Congo: An anti-crisis strategy has been put in place, monitored by an inter-ministerial committee. It includes a programme to upgrade the skills of both employed and unemployed workers in a way that responds to labour market requirements.

109. Greater use of active labour market programmes could also be foreseen for some developing and emerging countries. A recent study shows that some 12 out of 31 economies in Latin America and the Caribbean are indeed already using active and passive labour market policies in response to current economic circumstances.[63] The cost of new programmes is relatively low. For example, Argentina's spending peaked at about 1 per cent of GDP. Based on this cost level, such programmes could be an appropriate tool if there is political will by policy makers.

Leveraging local partnerships to enhance effectiveness

110. The effectiveness of employment-intensive investments, skills development and active labour market programmes can be improved by leveraging capacity among local partners – the foundation upon which the ILO's employment-intensive investment programme is built (Box 7).

Box 7. The ILO's Employment-intensive Investment Programme

The ILO's Employment-intensive Investment Programme works with governments, employers' and workers' organizations, the private sector and community associations in orienting infrastructure investments towards the creation of higher levels of productive employment, as well as towards the improvement of access to basic goods and services for the poor. Many of the programme's projects rely on labour-based technologies, in order to generate local employment and incomes and develop skills.
Labour-based technologies have several benefits: they are between 10 and 30 per cent less costly than more equipment-intensive options; foreign exchange requirements are reduced by about 50 to 60 per cent; between 2 and 4 times more direct employment opportunities are created for the same investment; indirect employment ranges between 1.5 and 3 times the numbers of direct jobs stemming from the initial investment. Over the last 30 years the programme has played a vital role in over 60 countries in Africa, Asia and Latin America in dealing with job creation and poverty reduction in rural and urban areas. It has also developed methodologies to ensure cost effectiveness of the measures.

Enhancing social protection, especially among low-income groups

111. As earlier sections illustrated, as the crisis unfolds, the risks that individuals around the world are facing are exacerbated by limited access to social security schemes and social safety nets. At the same time, in countries where such schemes do exist, pressures on their finances, e.g. pension systems, are intensifying as countries experience the double burden of declining tax contributions and increasing expenditures due to rising claims.

Well-designed social policies can alleviate the consequences of the crisis in the short run…

112. Supporting workers and their families through well-designed social policies – a core ILO competency – is a key component to averting a social crisis and stimulating the

[63] Economic Commission for Latin America and the Caribbean, 2008.

economy more broadly.[64] Neglecting victims of the crisis, and of the interconnecting food, energy and poverty crises, would be unfair and could undermine support for government rescue plans. Moreover, supporting low-income groups, which typically have a high propensity to consume, would help stimulate aggregate demand and restore confidence.

…by helping low-income and other vulnerable groups while supporting the recovery…

113. One way to provide assistance to individuals is to widen eligibility conditions and increase benefit amounts of existing social security schemes, e.g. by extending the duration or increasing the generosity of unemployment benefits (see Table 4 for examples of countries that have already done this). In the absence of existing schemes, however, it may be necessary to introduce new measures to help low-income and other vulnerable groups.

114. For example, income support measures such as conditional cash transfers could be further strengthened (or introduced) to enhance human capital and access to education and health services, especially for the poor (see Box 8). This is particularly relevant given that in many low-income countries, crises are associated with poorer health and education outcomes for children, while in middle-income countries, they are associated with poorer health outcomes.[65] Investments in children's education and health services also have a long-term systemic impact on poverty levels. Social and care services also provide job opportunities for women who may not be able to take up construction work on infrastructure projects.

Box 8. Conditional cash transfers

Conditional cash transfers provide cash to poor families linked to certain educational and health-related conditions. The most common conditions focus on children's school attendance, health care check-ups and nutrition. Recent studies show that one-third of developing countries have implemented some kind of cash transfer programmes.

Conditional cash transfers have been effective at smoothing recipients' consumption during times of crisis. For example:

- In Nicaragua, during the Central American coffee crisis, they smoothed consumption, protected children's school enrolment, reduced child labour and improved health outcomes.
- Similarly, in Honduras, they allowed families to keep their children in school during the crisis.
- They were also successfully introduced as part of earlier crisis responses in Colombia and Turkey.
- Indonesia's scholarship and school subsidy programme was introduced in 1998 as a part of the government's crisis response.[66]

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[64] See for example E. Lee: *The Asian Financial Crisis: The Challenge for Social Policy*, ILO, 1998.

[65] Children's human capital outcomes are not uniformly affected in a crisis. For instance, during economic or environmental crises, health outcomes suffered in the Philippines and Uganda, while education outcomes were not dramatically affected in Brazil, Indonesia and Uganda (see E. Skoufias: "Economic Crises and Natural Disasters: Coping Strategies and Policy Implications", in *World Development*, Vol. 31, No. 7, 2003, pp. 1087–1102). World Bank: *Lessons from World Bank Research on Financial Crises,* Policy Research Working Paper No. 4779, 2008

[66] For some evaluations of these programmes, see van W. Ginneken: *Managing risk and minimizing vulnerability: The role of social protection in pro-poor growth*, ILO, 2005; S. Handa; B. Davis: "The Experience of Conditional Cash Transfers in Latin America and the Caribbean", in *Development Policy Review*, Vol. 24, No. 5, 2006, pp. 513-536; L. Rawlings; G. Rubio: "Evaluating the impact of conditional cash transfer programs", in *The World Bank*

115. In cases where conditional cash transfers do not exist, establishing a new programme can be a complicated, time-consuming and administratively challenging process, entailing considerable data-collection and monitoring capacity which may be difficult to mobilize in times of crisis. Consequently, in low-income countries where poverty is widespread and administrative capacity limited, unconditional transfers could be considered as a way to enhance universal social protection.

116. A wide range of other tools and targeted intervention programmes could be envisioned to support vulnerable groups such as workers in the informal sector and rural areas, e.g. the labour-intensive public works programmes as undertaken by many governments during crises (Argentina, Indonesia, Republic of Korea and Thailand). As discussed above, employment guarantee programmes of this nature can potentially combat both poverty and unemployment with positive secondary effects on, among other things, health, crime and political stability. Other types of income and employment entitlement programmes, such as those offered by the Self Employed Women's Association in India or the Grameen Bank in Bangladesh, could also help provide much needed social protection to vulnerable groups in times of crises. For programmes targeting informal workers, particular attention to the gender dimension will be crucial.[67]

…and protecting pensions from the volatility of stock markets

117. In order to avoid losing ground both against existing poverty thresholds and the rates of replacement income provided, it is necessary to restore solidarity-based minimum guarantees of pension amounts underwritten by the State, and protect the pension levels of individuals who are close to retirement. In certain countries (such as India), the elderly rely heavily on income from savings, which is likely to be severely curtailed with current interest rate drops. In addition, in countries that rely on annuitization of individual savings accounts, any prolonged suppression of interest rates is likely to lead to serious difficulties because of increased volatility in annuity rates (prices).

118. As a transition measure, a minimum pension based on a reasonable minimum rate of return ought to be financed or guaranteed by the State. Governments could also authorize pension schemes to reduce their levels of capitalization. One possible approach is to allow schemes to go into temporary actuarial deficit. If asset prices rebound in due course, then the ultimate net cost of such guarantees would be only a fraction of the momentary losses of pension assets.

Research Observer, Vol. 20, No. 1, 2005, pp. 29-55; and R. Sparrow: "Protecting Education for the Poor in Times of Crisis: An Evaluation of a Scholarship Programme in Indonesia", in *Oxford bulletin of economics and statistics*, Vol. 69, No. 1, 2007, pp. 99-122.

[67] A. King-Desjardin; *Gender dimensions of globalization*, discussion paper presented at the Oslo Conference on Decent Work: A key to Social Justice for a Fair Globalization, 4 September 2008.

119. The OECD has suggested that governments could play a more active role in managing the risks associated with the payout phase of pensions and annuities. In particular, governments could encourage the development of longevity-hedging products by producing an official longevity index. Other proposals include suggestions for governments to issue longevity bonds that "would set a benchmark for private issuers", while also giving consideration to issuing more long-term and inflation-indexed bonds – a move already taken by a small number of countries, most recently the Danish government, which released a 30-year bond that was primarily bought by domestic pension funds and insurance companies.

But these measures should form the basis of a broad-based social protection for all…

120. While the above measures to protect the most vulnerable are important steps to addressing current challenges, they should form part of a systematic effort to develop a broad-based social security system (covering social assistance, education, health, unemployment benefits, etc.) and an overall poverty reduction strategy.

… which can help mitigate the impacts of future crises…

121. Experience in several European and, more recently, some Asian countries has shown that a system of basic social security can mitigate the impacts of crises by means of automatic stabilizers – measures of support that automatically increase during times of crises or increased household vulnerability.

…and, if consistent with employment goals, support development objectives

122. Moreover, increases in social spending do not impede growth. On the contrary, if social protection is designed in a way that takes into account work incentives, it can boost the quality of growth through its pro-poor elements. For example, countries that have high social spending also tend to have lower levels of poverty and inequality.[68] In other words, social security measures should, and can, be designed in such a way as to go hand in hand with economic policy to increase production, social protection and redistribution while addressing broader social issues such as family, care and poverty.

123. Just as the Great Depression was a defining moment in the United States in creating the Social Security Act (1935) and the financial and economic crises of the 1990s were defining moments in Asian and Latin American social policy innovation, this current crisis should be taken as an opportunity to enact much-needed reforms to social security systems. In this respect the Social Security (Minimum Standards) Convention, 1952 (No. 102) can guide efforts to strengthen social security systems.

Protecting the rights of workers

124. In attempting to address the challenges associated with the crisis, it is crucial to ensure that workers' rights and international labour standards are not compromised in the process. In fact, the observance of fundamental principles and rights at work must be part of the solution to the crisis. Moreover, respect for fundamental principles and rights at

[68] ILO: *World of Work Report 2008.Income Inequalities in the Age of Financial Globalization,* IILS, Geneva, 2008.

work is necessary to maintain social justice and peace, and to avoid political unrest which could create even greater delays in terms of a recovery.

Reduced labour standards would be both unfair and counter-productive…

125. Some argue that labour market rigidity and overly stringent labour standards restrict the capacity of an economy to cope with economic shocks and that labour market flexibility can temper both the depth and duration of unemployment in the current crisis.[69] However, there is considerable evidence drawn from cross-country studies that illustrates that there is no clear relationship between fewer labour regulations and faster economic and employment growth.[70] Efforts that are focused exclusively on speeding up the labour market adjustment process to cope with the global economic crisis run the risk of impairing long-term growth potential.

126. Maintaining labour standards helps support confidence and thus contributes to activating the economy. Moreover such measures would be equitable and enable vulnerable workers to deal with labour market risks, thus enhancing popular support for recovery packages. The different national situations now arising in the context of the crisis highlight the relevance of the ILO's full complement of instruments to protect workers' rights (see Box 9).

Box 9. Relevance of ILO instruments in the crisis context

The ILO has a comprehensive set of instruments to protect workers' rights. The following are examples of the relevance of these instruments in the context of the crisis:

- As pressures on firms mount, the Protection of Wages Convention, 1949 (No. 95) and the Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173), along with their associated Recommendations, lay out constructive measures for protecting workers' wages and proceeding fairly in cases of an employer's insolvency. Where lay-offs arise, it is important to ensure that terminations are not discriminatory on any of the grounds provided in the fundamental Conventions. The Termination of Employment Convention, 1982 (No. 158) and Recommendation (No. 166) shed light on how terminations can take place in a balanced manner. The provisions of the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) could be particularly useful in managing the effects of the recession along global supply chains. To protect the employment security of workers in atypical employment situations, the Employment Relationship Recommendation, 2006 (No. 198) is salient.
- Instruments concerning migrant workers (the Migration for Employment Convention (Revised), 1949 (No. 97) and the Migrant Workers (Supplementary Provisions) Convention, 1975 (No. 143)) are also highly relevant, given that this group is particularly vulnerable in the context of the downturn in labour markets.
- The Labour Clauses (Public Contracts) Convention, 1949 (No. 94) can help ensure that investments financed by public stimulus packages generate jobs with decent pay and working conditions.
- In the context of enhancing social protection, the eight fundamental Conventions (Forced Labour Convention, 1930 (No. 29); Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87); Right to Organise and Collective Bargaining Convention, 1949 (No.

[69] This is under the assumption that in rigid labour markets, relative prices (wages in this case) are sticky, and therefore the brunt of the adjustment process is borne via the depth and duration of unemployment.
[70] J. Berg; D. Kucera: *In defence of labour market institutions. Cultivating justice in the developing world*, ILO, Geneva, 2008; A. Ghose; N. Majid; C. Ernst: *The Global Employment Challenge*, ILO, Geneva, 2008; Baker *et al.: Labour market institutions and unemployment : A critical assessment of the cross-country evidence*, 2005.

98); Abolition of Forced Labour Convention, 1957 (No. 105); Equal Remuneration Convention, 1951 (No. 100); Discrimination (Employment and Occupation) Convention, 1958 (No. 111); Minimum Age Convention, 1973 (No. 138) and Worst Forms of Child Labour Convention, 1999 (No.182)) can guide poverty alleviation efforts and, along with Convention No. 102, efforts to strengthen social security systems. Fundamental Conventions are crucial to ensuring a more balanced distribution of the gains from economic growth and reducing excessive inequalities –a key factor behind the crisis.

- Social dialogue mechanisms and processes, as outlined in the Tripartite Consultation (International Labour Standards) Convention, 1976 (No. 144), and the Tripartite Consultation (Activities of the International Labour Organisation) Recommendation, 1976 (No. 152), as well as in the Consultation (Industrial and National Levels) Recommendation, 1960 (No. 113) and the MNE Declaration, need to be part of the strategy.
- Overall, the Employment Policy Convention, 1964 (No. 122) – based on policies for full, productive, and freely chosen employment – can provide a useful overarching framework for international action.

… and the crisis represents an opportunity to emphasise the role of workers' rights

127. The crisis should be taken as an opportunity to reinforce the value of protecting and respecting workers' rights.[71] Measures should be taken to guarantee impartial and efficient judicial, as well as extra-judicial, proceedings dealing with individual and collective disputes. Labour inspection and administration systems should be reinforced to guarantee implementation of measures taken to combat the crisis and its social consequences and to provide services to employers and workers. Public employment services and labour inspection have a special responsibility in this regard.

128. Better enforcement of workers' rights could help achieve more balanced income developments and thus reduce the risk of future crises.[72] A consistent finding is that countries that have 'labour-friendly' regulations seem to be associated with lower wage inequality – a tangible social benefit – without imposing any significant loss in terms of output and employment.[73] A rights-based approach to the crisis can thus anchor the discussion of policy options, to enhance social justice in the immediate and longer term.

The role of social dialogue and wage determination

Social dialogue plays an essential role in protecting rights and achieving employment objectives …

129. The Declaration of Philadelphia established the ILO's commitment to social dialogue, tripartism and participation. Its central importance has been sustained over the decades. More recently, in 2002, the International Labour Conference adopted a resolution concerning tripartism and social dialogue, recognizing that social dialogue plays an essential role in the achievement of employment objectives and the improvement of social protection. Social dialogue can be instrumental in adopting

[71] L. Rychly: *Social dialogue on the design and implementation of measures in times of global financial and economic crisis*, ILO, forthcoming 2009.
[72] J. Berg; D. Kucera: op.cit.
[73] See for example, R. Freeman: *Doing the Right Thing? Does Fair Share Capitalism Improve Workplace Performance?: Analyzing Effects in Britain*, with Alex Bryson, presented at the Shared Capitalism Research Conference, NBER-Sage Foundation, 6-7 October 2006.

effective, concrete policy responses by helping to improve the design of reforms, and it can help to bolster support for reforms in general.[74]

… social partners can be instrumental in designing and implementing reforms for overcoming the crises...

130. At the 8th European Regional Meeting of the ILO (Lisbon, February 2009) participants emphasized the significance of social dialogue as a key means of developing strategies to counter the recession and secure the commitment of governments, employers and unions for implementation of the strategies.[75] Indeed, examples from past crises can be identified which illustrate how national tripartite consultations have played an important role in overcoming severe economic difficulties. For example, in Singapore measures were introduced to mitigate excessive layoffs, whereas in the Republic of Korea, eventual agreement improved the government's crisis-management capacity, and was instrumental in reaching national consensus (Box 10).[76] In addition, Argentina's post recovery process was based on a social pact bringing all the social partners together.

Box 10. **Lessons from social dialogue in previous crises**

Singapore: To counter the 1997-1998 financial crisis, the government introduced new labour policies. In particular, as a result of a tripartite agreement, employers received financial incentives if they avoided layoffs. Tripartite institutions as well as ad hoc tripartite agreements were very effective in articulating conflicting interests between the three parties, resulting in more effective formulation and implementation of social and economic policies.

Republic of Korea: To respond to the 1997-1998 financial crisis, a Tripartite Commission was created. The Commission had two major objectives: to contribute to economic restructuring and to involve social partners in the revision of Korean labour law, in line with ILO standards. A Social Agreement adopted by social partners in February 1998, accepted layoffs of redundant labour force as an economic reality, but it also significantly enlarged workers' basic rights, substantially expanding freedom of association and the right to bargain collectively, both in the private and public sectors. This "Great Compromise" improved the government's crisis-management capacity, and was instrumental in reaching national consensus and helping the country overcome the credit crunch.

…and finding pro-decent work solutions to immediate and longer-term challenges…

131. At the national level, the existing institutional framework, as well as newly established consultative bodies, should be used to identify and implement appropriate national policies. Where these bodies do not exist, *ad-hoc* high-level meetings should be held to exchange information and to consult or negotiate policy measures. In difficult times, it is of particular importance to build and maintain mutual trust between the State and the social partners and among the social partners themselves. The ILO can play an important role in this context. Social dialogue and collective bargaining are powerful tools to cope with immediate challenges of the crisis, such as preventing social unrest, avoiding damaging industrial actions, reducing income inequalities and maintaining

[74] See L. Rychly: op.cit.
[75] See GB.304/14/4.
[76] For a comprehensive discussion of social dialogue in the post-crisis context, see D. Campbell: "Social Dialogue and Labour Market Adjustment in East Asia after the Crisis", in G. Betcherman, R. Islam, (eds.): *East Asian labor markets and the economic crisis: Impacts, responses and lessons*, World Bank and ILO, 2001.

social cohesion. Through improved governance social dialogue can also pave the way for shared prosperity and stability in the longer term.[77]

… especially as regards wage developments – a particularly contentious issue

132. One point of contention is wage-setting practices. In particular, some advocate wage moderation in an attempt to cut costs and prevent job loss in ailing firms. Others argue for maintaining purchasing power and aggregate demand.

Overall, to sustain the recovery, average real wages should grow in line with productivity and minimum wages should not fall…

133. Paradoxically, both views are probably valid. On the one hand, firms are facing significant financial difficulties and their viability, including that of the employees, may rely on significant cost reductions. Such reductions, which take the form of, among others, wage freezes or cuts – perhaps even in line with productivity declines –can help firms survive and avoid layoffs.[78] In addition, earlier experiences in Asia and Latin America show that lower wages played a strategic role in the response to the crisis. Lower wages, together with currency devaluations, resulted in massive improvements in external competitiveness. The latter, in turn, was instrumental in the recovery of these countries.

134. On the other hand, given the global nature of the current crisis, a generalization of wage restrictions in the name of competitiveness and better profitability would most likely push the world economy into further trouble. This is a real risk. Indeed, excessive wage developments are not the cause of the crisis. In fact, evidence suggests that real wages have tended to grow *below* productivity gains since the early 1990s.[79] On average, pre-crisis profit rates were high by all standards. So, unlike the crisis of the early 1980s, low profitability has not been the main problem for most enterprises. In addition, stagnant median wages and incomes were an enabling factor behind excessive debt accumulation.

135. Altogether, as a response to the crisis as well as from a longer term perspective, it would be economically desirable – as well as fair – if average wages would grow over the medium-term in line with productivity gains, taking into account firms' viability in the short-run. In light of the evidence to date, this may mean that wages may need to rise faster during economic upswings and less rapidly during downswings.

136. In this respect, the role of collective bargaining and social dialogue will be critical to achieving a desirable outcome. Employers and workers need to be encouraged

[77] Countries with coordinated collective bargaining have been shown to have less wage dispersion compared to other countries. T. Aidt; Z. Tzannatos: *Unions and Collective Bargaining: Economic Effects in a Global Environment*, World Bank, Washington, 2002.
[78] Other measures to avoid job loss were discussed throughout the report.
[79] ILO: *Global Wage Report*, November 2008; ILO: *World of Work Report 2008. Income Inequalities in the Age of Financial Globalization*, IILS, Geneva, 2008.

to participate in collectively negotiated wage-setting practices. Governments can help stimulate dialogue and facilitate concerned action to avoid socially undesirable, and potentially inefficient, generalized wage reductions. Moreover, collective bargaining can reduce overall wage inequality and ensures a stronger link between economic growth and average wages.[80]

137. Governments can support this process through minimum wage legislation, adjusted regularly to maintain the purchasing power and avoid sudden adjustments, which are detrimental to job creation. The Minimum Wage Fixing Labour Convention, 1970 (No. 131) provides an important benchmark in this regard.

[80] ILO: *Global Wage Report*, November 2008.

IV. Improving global policy coherence for more balanced growth and development

138. The need for greater global policy coherence has been emphasized many times, and for good reasons. But it is especially important now. Unless greater international coordination is achieved in the responses to the crisis, the world economy will face the prospect of a protracted economic crisis, entailing an even deeper labour market crisis and significant social hardship. Greater coherence is also needed at the global level. No international organization or country has the mandate for, or is equipped to treat, all facets of the crisis and its underlying challenges. This is why the G20 has emerged as a key forum to discuss the crisis.

139. The ILO has therefore committed itself to fostering greater cooperation among national governments, international organizations, and other stakeholders in support of a stronger, cleaner and fairer economy.[81] It is important to build on complementarities between the ILO and the different mandates of other international organizations – particularly the World Bank, the IMF, the WTO, and the United Nations Environment Programme, among others – to enhance coherence between economic, financial, trade, social, environmental and development goals.

Avoiding in-ward looking and protectionist solutions

140. The global crisis will not be solved by protectionist solutions. Rather, such solutions would depress world trade and investment, further aggravating the recession. Historical evidence from the Great Depression shows that attempts to restore economic stability by closing borders to trade are bound to fail and would generate even more substantial income and employment losses in the long-run. The repercussions for developing countries, which rely so heavily on world markets, would be especially acute.

141. The role of the multilateral system is critical and it will be important to remain vigilant vis-à-vis the mounting pressure to support strategic sectors like automobiles. Support should be temporary and tied to social and environmental conditions. To complement this, however, it is of paramount importance to help workers adjust, through a variety of training and re-employment measures as discussed earlier.

142. Likewise, attempts to overcome the crisis through competitive currency devaluations would be counterproductive. Some countries have already had recourse to strong devaluations. In some cases, this may be justified on the basis of economic fundamentals. However, currency devaluations with the aim of improving competitiveness will not help overcome the global crisis and may aggravate trade

[81] See the joint press release by Chancellor Angela Merkel, OECD Secretary General Angel Gurría, WTO Director-General Pascal Lamy, ILO Director-General Juan Somavia, IMF Managing Director Dominique Strauss-Kahn and World Bank President Robert B. Zoellick on the occasion of their meeting on 5 February 2009 in Berlin.

tensions. Here too, an orderly adjustment, through proper international cooperation is clearly desirable.

143. Generalized wage deflation to protect individual economies would aggravate the crisis even more than a wave of competitive devaluations. Indeed, wage deflation would deprive the world economy of much-needed demand and would also seriously affect confidence. Open market policies, which are so crucial to the recovery, would also face a risk of backlash if workers perceive the measures as unfair.

Reforming the financial architecture so that it serves the needs of the real economy…

144. Medium and long-term measures to overhaul the financial regulatory framework are required to move towards a more stable global financial system. Previously widespread practices – such as excessive leveraging, opaque financial instruments and executive compensation schemes – need to cease.[82] In a few cases, limits on executive pay and bonuses have been instituted as a condition for government assistance. But a more profound change is clearly called for.

145. Indeed, despite the coordinated international responses in the short-run, the global financial system is likely to remain marked by volatility until significant structural adjustments are made. Therefore, in all countries, it will be crucial to reinforce prudential regulation to reduce excessive and irresponsible short-term risk-taking on the part of certain financial actors. For instance, lightly regulated markets for financing mechanisms such as private equity, hedge funds and non-bank financing have been held responsible, in part, for sudden herd-like in- and out-flows of funds in certain industries and sectors which may have magnified the effect of the current crisis. A cautious approach to regulation is especially important in countries where financial markets are not sufficiently developed and where supervision mechanisms are weak. The "de Larosière report" provides a rich menu of how to move forward in this regard. [83]

…and takes into account the social impacts of different reform options

146. The regulatory reforms made in the coming months and years must be assessed against their social impacts and implications for employment growth. As the International Labour Conference emphasized in 2007, financial services can indeed be used to promote decent work outcomes, if regulated appropriately.[84] Any new financial system should therefore give incentives for productive investments in sustainable enterprises and decent work, and disincentives to short-term speculation.

147. In this regard, the ILO has an important role in highlighting the social impacts of the reforms to strengthen the inclusiveness of a new financial architecture and help the international community strike the right balance between government regulation and

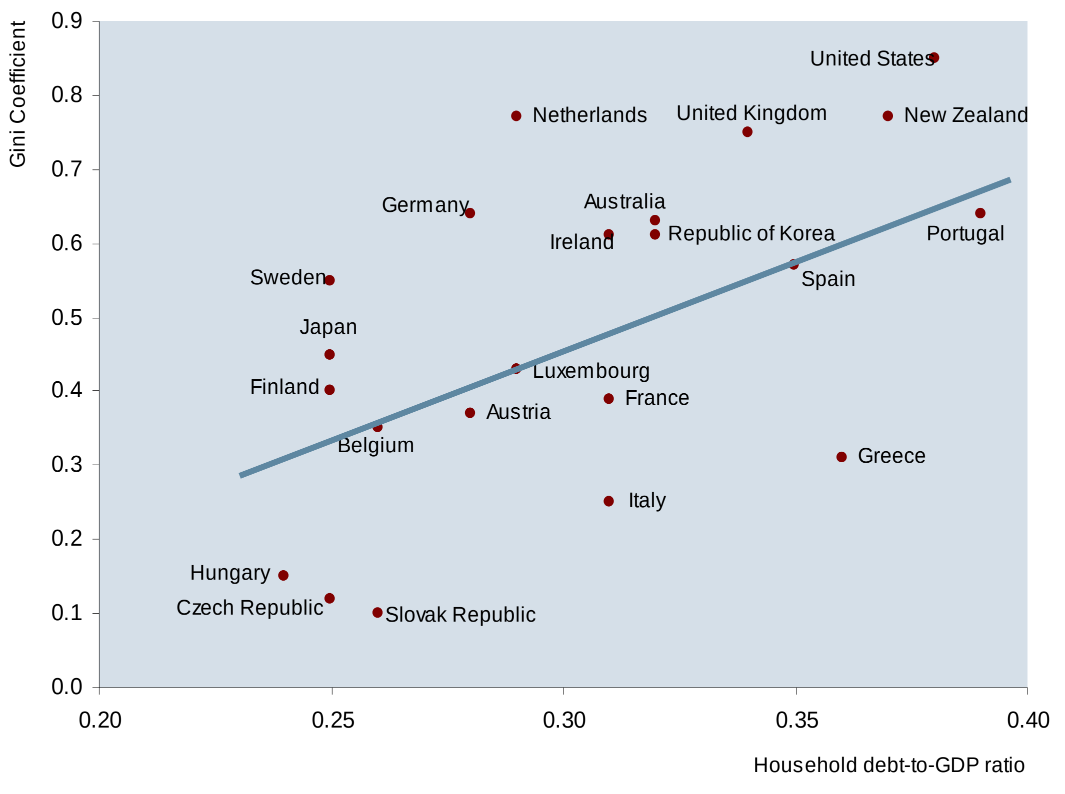
[82] For a recent analysis of executive pay, see F. Ebert, R. Torres, and K. Papadakis: *Executive Pay: trends and policy issues*, International Institute for Labour Studies, Discussion Paper No. 190, ILO, Geneva, 2008.
[83] Available at http://ec.europa.eu/ireland/press_office/news_of_the_day/pdf_files/global_report_-_final.pdf
[84] ILO: *The promotion of sustainable enterprises*, Report VI, International Labour Conference, 96th Session, Geneva, 2007.

corporate self-determination. The ILO's Social Finance Programme, supported by analytical work[85], provides a major benchmark in this respect.

Promoting social sustainability of economic growth…

148. One of the most significant challenges will be to ensure a more equitable distribution of the gains from globalization, as highlighted in the Social Justice Declaration. This is important in and of its own. In addition, as noted in the first section of this paper, excessive inequalities are a key factor behind the financial crisis. Among advanced economies, high income inequalities tend go hand-in-hand with a greater burden of household debt (Figure 13).

Figure 13. Household debt and income inequality in some OECD countries, 2005



Source: Estimates based on OECD data.

149. Moving forward, this means ensuring that tax policies are more progressive than hitherto – which requires international coordination so as to avoid harmful tax competition to attract high-income groups and businesses. Social protection reforms, as discussed in the third section of this paper, can be designed in such a way that they serve both equity and efficiency purposes.[86] Also, countries that have stronger tripartite

[85] See for instance B. Balkenhol: "Access to finance: the place of risk sharing mechanisms", in *Savings and Development* No.1, vol. XXXI, 2007, pp.69 - 90.
[86] ILO: *World of Work Report 2008. Income Inequalities in the Age of Financial Globalization*, International Institute for Labour Studies, Geneva, 2008.

institutions are better placed to ensure that the gains from globalization are distributed in a balanced manner. Finally, rising non-standard and informal employment – which tend to pay less than formal standard jobs – have contributed to rising income inequalities in developed and developing countries alike. More attention is therefore needed to the quality of employment created.

150. Financial globalization too, has reinforced the downward trend in the share of income going to labour and more fundamentally, has intensified economic instability. A new financial architecture, along the lines discussed above, must consider these social consequences in order to produce more stable and equitable employment and economic growth.

…as well as environmental sustainability

151. Globally, increased emphasis has been placed on investing in energy efficient technology for greener and more sustainable growth, and several governments have announced stimulus programmes designed to make progress in that regard (see Box 11). In some cases, the bulk of "greener" jobs created is likely, at least initially, to be in traditional sectors such as construction. Nevertheless, green investments should be viewed as an important step towards revitalizing the economy and generating more environmentally-friendly, decent work. And, in the medium to longer term, such investments can put countries on a path toward greener and more sustainable growth.

Box. 11 Green investments and job creation as a response to the crisis: some examples

***Japan**:* To strengthen growth potential and move to a low-carbon society, the government plans to invest 100 trillion yen in green projects by 2015 which would create more than 2 million jobs in environmental businesses. The “green” initiatives include: accelerating the introduction of energy-saving and new energy technologies; subsidies for the development of the next generation high-speed railway; tax incentives for investments in energy-saving and new-energy facilities and equipment; and greater resources for research and development on cutting-edge environment technologies, including carbon dioxide capture and storage.

Republic of Korea: The government recently announced new investments in the order of $38 billion for a series of “green” initiatives to be rolled out over 2009-2012. This “Green New Deal” provides for nine core projects and 27 subsidiary projects in areas such as the restoration of major rivers, renewable energy, energy conservation, green transportation, clean water, recycling, and carbon reduction. These projects are expected to create as many as 960,000 new green jobs.

United States: The *American Recovery and Reinvestment Act,* signed by the President of the United States on 17 February 2009, includes significant investments in clean energy programmes. $5 billion is allocated for programmes to help low-income households weatherize their homes, which is expected to create about 375,000 jobs. Grants for energy efficiency in residential and commercial buildings amount to over $6 billion. These may create more than a million jobs, particularly in the construction sector, which has been hard hit by the recession.[87] $500 million is allocated to help workers train for “green jobs”, while $11 billion is allocated for “smart grid” investments, $3.4 billion for carbon capture and sequestration demonstration projects, and $2 billion for research into batteries for electric cars.

[87] D.J. Weiss, A. Kougentakis: *Recovery Plan Captures the Energy Opportunity*, Center for American Progress, 13 February 2009.

Addressing the development dimension…

152. Even before the onset of the current financial crisis, significant food, education, health, social and environmental challenges existed for many developing countries. And the crisis is likely to aggravate the situation.

…by building capacity, notably administrative and institutional in developing countries…

153. As outlined in the third section of this paper, the ILO has developed expertise to help promote development through decent-work-friendly policies. The following are important policy elements of the global jobs pact: the implementation of job-rich infrastructure and housing projects, the fight against child labour and in favour of schooling, the build-up of social protection systems as fiscal conditions permit, and the enlargement of the fiscal space through well-designed policies that facilitate transition to the formal economy. In this context it is to be kept in mind that respect for core labour standards is not only a key social goal, but also creates the conditions for balanced economic development, itself conducive to greater prosperity in the long-run.

154. It is crucial to build up administrative and institutional capacity to make these programmes effective and to engage social dialogue as part of the strategy. The recent Mexican anti-crisis reform ("*Acuerdo nacional en favor de la economía familiar y el empleo*") provides an interesting example of what can be done.

… and creating a global jobs fund

155. Some countries are better-positioned than others. For example, those which took steps to better manage their economies and avoid excessive risk-taking and leverage are likely to be impacted less. Others are confronted with an array of challenges including limited fiscal space, a fragile current account, and potential runs on their currency. Indeed, countries inheriting large fiscal and current account deficits will be much more vulnerable, especially if these imbalances are driven by exogenous circumstances (most notably the need to cope with the terms of trade shock unleashed by the food and fuel price crisis of mid-2008).

156. Circumscribing policy options of particular developing countries with a framework of conditionalities by international financial institutions will compound the difficulties faced by such countries (see Box 8).[88]

157. What is needed is a counter-cyclical global mechanism, as advocated by some analysts.[89] For instance, a global jobs fund would provide support to countries facing the global crisis. It would rely on a line of credit separate from that of the traditional IMF package. And it would provide the necessary stabilization credit needed to sustain the

[88] More details on these issues will be provided in a forthcoming ILO publication by Employment Sector specialist.
[89] See for instance UNDESA: *Massive, globally coordinated fiscal stimulus is needed: going from the drawing board to swift action,* Policy Brief No. 11, January 2009. Also, the World Bank has called for the creation of a fund to help vulnerable countries.

external crisis without aggravating social hardship. Indeed the credit would not be subject to the condition that social protection and minimum wages be cut. Instead, it would be used to help revitalize the economy through investments that strengthen development prospects. Importantly, the measures would be adopted as part of national dialogue, so as to improve social cohesion. Involvement of the ILO, side by side with IMF and World Bank, would be crucial. Indeed, as shown in the third section of this paper, ILO has the expertise to design programmes that help create decent work and sustainable enterprises.

158. The President of the UN General Assembly has established the Commission of Experts on Reforms of the International Monetary and Financial System (the so-called Stiglitz Commission) to draw attention to the asymmetries in the capacities of developed and developing nations to respond to the crisis, among a range of other important issues. Through its position in the UN system, the ILO can support the Commission's work by pointing to the employment and social consequences of existing and proposed solutions to crises in developing countries.

Box 12. Macroeconomic stabilization in the wake of financial/economic crisis

Pakistan: In November 2008 Pakistan entered a stand-by arrangement with the IMF for a $7.6 billion adjustment programme to cope with its rising fiscal and current account deficits and price inflation. The adjustment programme calls for a reduction of the fiscal deficit to 4.2 per cent in 2008-09, and to 3.3 per cent during 2009-10, and an interest rate hike of 200 basis points to 15 per cent. These measures would inevitably dampen aggregate demand and the government has already lowered its growth rate forecast from 5.8 per cent achieved in 2007-08 to 4.4 per cent in 2008-09, with official admissions of worsening of unemployment and poverty. They would also run counter to policies advocated in international *fora* to stimulate the global economy. Indeed, the above *pro-cyclical* measures are likely to dampen global demand even further, and exacerbate poverty and unemployment in both Pakistan and its trading partners.

Ukraine: Between 2000 and mid 2008 Ukraine's economy was buoyant, with average annual growth in excess of 7 per cent. The fiscal position of the country was generally sound and the level of public foreign debt was moderate. However, in November 2008 the country signed a standby agreement with the IMF for $16.4 billion. This move came as a result of Ukraine's faltering economy in the second half of 2008 when commodity prices declined sharply, export markets contracted, and a large bank was placed under receivership – events which sparked massive capital outflows, a crisis on the foreign exchange market, significant currency devaluation, a major credit crunch in the real economy, and a massive increase in unemployment.

The recapitalisation of commercial banks is a high priority in the standby agreement with the IMF, but this is an extremely expensive undertaking. It is estimated that bank recapitalisation will cost at least 8 per cent of GDP, including 4.5 per cent of GDP for recapitalisation of foreign-owned banks. Given that a significant proportion of the recapitalisation costs will be borne by the government, at a time when tax revenues are declining dramatically, the government is required to significantly reduce other areas of public expenditure to produce a balanced budget in 2009 (as per IMF provisions).

Much of the fiscal tightening is expected to come through reduced expenditure on public sector wages and benefits, reductions in the overall level of social expenditure, revised indexation arrangements for social transfers, and a postponement of a planned increased in the minimum wage. These reforms imply a significant decline in the real value of pensions and other transfer payments, and a fall in real minimum wages. While it is important to restore the flow of credit to viable enterprises, the costly recapitalisation of the banks raises concerns, particularly when the opportunity cost is a substantial reduction in public expenditure on social security.

Source: Planning Commission: *Economic Stabilization with a Human Face,* Report of the Panel of Economists, GOP, October 2008; Z.M. Nasir: *National Policy Responses to the Financial and Economic Crisis*, 2009 (mimeo), (Pakistan); R. Kyloh and C. Saget: *A common crisis but contradictory responses: The European experience 2008/09*, (Ukraine), ILO Policy Integration Department, forthcoming 2009.

In sum, a global jobs pact with decent work principles at the fore can pave the way for a more sustainable economy in the longer term

159. It is imperative that responses to the crisis should not just be seen as piecemeal measures to be rolled out temporarily, only to revert back to "business as usual" as soon as possible. The challenge now is to respond to the current crisis through measures, which, as discussed above, pave the way for a better pattern of growth and development. Global coordination efforts currently underway could increase the propensity for multilateralism to tackle development challenges more creatively and effectively in the future.

160. In this way, international partners can contribute to a better global economy and society, which, together with a new financial system, can form the foundation for more sustainable development. In this respect, the ILO has an important role to play within the multilateral system, in cooperation with its partners at the national level, to advance opportunities for women and men around the globe to live and work in conditions of freedom, equity, security and dignity.