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SESRIC MONTHLY REPORTS ON THE CURRENT GLOBAL FINANCIAL CRISIS

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UN Conference on the World Financial Crisis and Its Impacts on Development

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Background

The world economy is still suffering the crisis where economic downturn at historic magnitude and many countries across the globe, irrespective of their development level, are still under strain dealing with this crisis. The governments of many developed countries came up with hefty rescue packages whereby many leading banks and financial institutions in these countries have been bailed out. However, despite all rescue efforts and stimulus packages, developed economies are not yet back on track; growth rate expectations are grim, unemployment rates are increasing and businesses are closing down. Developing countries which mostly remained unaffected due to lower sub-prime mortgage exposure are also feeling the pinch due to declining trade, tightening of global finances and lower remittances inflows. In addition, due to fiscal and monetary constraints most of the developing countries could not manage to mitigate these negative effects of the crisis on their own. Consequently, in most of the developing world where millions of people are already suffering from poverty, hunger and malnutrition; the current global financial crisis is still predicted to have more severe implications for those people by reversing the progress made towards the achievement of the Millennium Development Goal (MDGs).

Indeed, there is a dire need to help the developing countries by providing more financial resources, trade facilitation and fulfilment of commitment related to Official Development Assistance (ODA).

To achieve this goal, all national, regional and international development agencies have to coordinate and cooperate to mitigate the negative effects of this crisis and work out measures and mechanisms to avoid re-emergence of such crisis in future. Against this backdrop, the United Nations convened a Conference on the World Financial Crisis and its Impacts on Development from 24 to 26 June 2009 in New York to assess the worst global economic downturn since the Great Depression. The aim was to identify and evaluate the responses initiated by different countries to mitigate the impact of the crisis and work out measures for the transformation of the international financial architecture by taking into account the views of all stakeholders i.e. all member states, international agencies, civil society organizations and private sector.

The conference included plenary sessions and four interactive roundtable exchanges among the stockholders for examining and overcoming the world financial and economic crisis and its impact on development by addressing the following issues: 1) the impact of the crisis on employment, trade, investment and development, including the achievement of the internationally agreed development goals and the Millennium Development Goals; 2) actions and appropriate measures to mitigate the impact of the crisis on development; 3) the role of the United Nations and its Member States in the ongoing international discussions on reforming and strengthening the international financial and economic system and architecture; 4) contributions of the United Nations development system in response to the crisis.

Before organizing this Conference, the United Nations Department of Economic and Social Affairs (UN-DESA) and the United Nations Development Programme (UNDP) co-moderated an e-discussion on the crisis and on policy responses to it. The first phase of the e-discussion was looking at how effective the response of the global system has been, what its shortcomings are, and how it can be improved. The second phase was examining the constraints under which national systems are functioning, and the trade-offs they are making to remain on the path of accelerated human development. The participants of the UN e-discussions were asked to give their views and comments on specific two main thematic questions.

The first question was as follows: *How is the international system (i.e. the UN and other multilateral institutions) responding to the current financial and economic crisis? What is the impact of these responses, in your country, as well as at regional and global levels? Are these responses sufficient both in addressing the current situation, and in preparing the system itself for the future? What are the critical gaps (if any) that remain?*

In their response to this question, the participants acknowledged that so far the efforts of international institutions have been effective in spreading the awareness and understanding of the crisis and its impacts among people and governments. As a result, governments especially in developed world came up with some joint responses and packages. However, the participants emphasised that while dealing with this crisis, international institutions and developmental agencies should not overlook the broader goals of development and challenges facing poor developing countries, especially in Africa. For example, most of the least developed countries rely heavily on aid and this crisis has intensified the need for aid more than ever. Hence, although the current crisis originated in developed countries (the traditional donors), the participants stressed the need for enhancing the efforts of the developed countries to ensure their fulfilment of aid commitments.

The participants also indicated that declining the export volumes of the developing countries due to weakening demand in developed countries is another major impact of the current financial crisis on the economies of the developing countries. Therefore, they recommended that developing countries should take serious steps to enhance their domestic demand for goods and services by improving livelihoods and raising incomes, including those of the rural population who are mostly engaged in agriculture. They called upon the UN and its specialised agencies to help and support these initiatives by developing state capacities building programmes in developing countries. It has been observed that the duplications of the efforts of the multilateral developmental agencies are causing wastage of valuable resources both financial and human. These agencies are, therefore, recommended to streamline their efforts by enhancing their cooperation and coordination, particularly through the fulfilment of the commitments made in the Paris Declaration on aid effectiveness and the following Accra agenda for action.

Furthermore, the participants proposed some necessary steps to be taken, especially for the benefit of the low income countries in order to speed up their structural transformation through increasing the output share of manufacturing products in their national income and adopting appropriate industrial policies. In this context, the participants called upon the international community to allow these countries to protect their domestic industries by imposing temporary protective measures and give free access to their market especially for the commodity dependent countries. The participants also emphasised the need in most developing countries to strengthen the relationship between education sector and labour market through the revision of human resource development policies and strengthening collaboration and coordination of health, education and labour institutions and ministries.

The second question was as follows: *How can the system of global economic governance be best strengthened for the future? What are some ways in which issues of legitimacy, effectiveness and relevance can be addressed? How should a greater voice for the under-represented (State and non-State actors) be enabled? What should be the key underlying principles to guide the changes – (e.g. inclusion, decentralization, regulatory diversity, and others)? What could be the most effective institutional arrangements?*

Regarding this questions, the participants indicated that the current system of global economic governance is inappropriate in terms of inadequate representation of countries at different development levels. This is true particularly for many developing and least-developed countries which have very limited representation in international governing and monitoring developmental institutions. This leads to serious concerns about the credibility and effectiveness of these institutions. Therefore, developing countries should be given more representation in all international financial and economic regulatory bodies to increase their credibility and accountability. The heads and senior management of Breton Wood institutions should be appointed through an open, transparent and merit-based selection process.

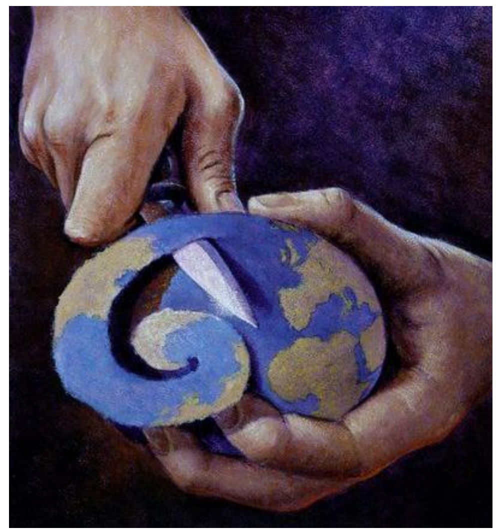
In order to include more developing countries in the governance of international regulatory bodies, the following measures have been proposed:

- Small and medium countries should have some representation in international regulatory bodies with more consistent regional representation.
- Attempts could be made to include some forms of representation from non-financial stakeholders, such as unions and non-financial corporations in both international and national financial regulatory bodies to balance their concerns, needs and perspectives.
- Such regulatory bodies should be made accountable to established forms of political representation at the appropriate national and global levels.
- Developing countries have benefited greatly from the support of the Group of 24 (G-24), which helps them develop their positions in relation to IMF and the World Bank matters. A similar body, possibly linked to the G-24, could be created for international regulatory issues, to help articulate developing country positions at bodies like Financial Stability Forum (FSF) and the Basel Committee on Banking Supervision (BCBS).
- It is highly desirable to work towards designing and creating a global financial regulator as financial markets will be even more global and sophisticated in the future.

In order to formulate an efficient and effective response plan to this crisis, the UN should help and support national governments especially in low income developing countries, with capacity building for monitoring the impacts of financial crisis on livelihood and welfare of different population groups at their national levels. This will facilitate the identification of those vulnerable people who are the most affected by the crisis and need more urgent assistance than others.

During the emergence of this crisis, global economic and financial regulatory bodies and developmental institutions failed to give an early warning and rapid countercyclical response mainly due to lack of effective channels of transmission and low level of mutual coordination. This emphasizes the need for building more effective partnership and coordination between governments, development agencies and regulatory institutions to develop an efficient early warning system and rapid response mechanism.

The Outcome of the Conference



The participants of the UN Conference on the "World Financial Crisis and its Impacts on Development" agreed upon the fact that the current financial and economic crisis, which initially started in developed countries, has been spread throughout the global economy and causing severe social, political and economic impacts. The downturn in world economy is still negatively affecting both developed and developing countries. The developing countries have been hit harder due to high prevalence of hunger and poverty, rising unemployment, poor access to education and health and inadequate social protection in the majority of these countries. Therefore, the human cost of the current crisis will be much higher in developing countries compared to developed countries. Another major problem faced by the majority of the developing countries is their inability to come up with fiscal stimulus packages, as was the case in the developed countries, due to their already over stretched financial resources. As a result, there is no doubt that this crisis is going to undermine and reverse the progress so far made towards the achievement of the MDGs in developing countries.

The Conference, therefore, agreed on the urgent need for identifying and assessing the negative impacts of the crisis on developing countries and called upon the international community to take strong and urgent actions to help developing countries restore their growth and recover from this crisis. Developing countries should be provided with additional resources- both short-term liquidity and long term development financing- for economic stimulation and regaining the lost ground in their progress towards developmental goals- including MDGs.

Current financial and economic crisis has been caused by a complex mixture of interconnected reasons including inconsistent and insufficiently coordinated macroeconomic policies, inadequate structural reforms and failures in financial regulation, supervision and monitoring. Based on the past experience, the Conference has identified several varied negative impacts of this crisis as follows:

- Rapid increases in unemployment, poverty and hunger
- Deceleration of growth, economic contraction
- Negative effects on trade balances and balance of payments
- Dwindling levels of foreign direct investment
- Large and volatile movements in exchange rates
- Growing budget deficits, falling tax revenues and reduction of fiscal space
- Contraction of world trade
- Increased volatility and falling prices for primary commodities
- Declining remittances to developing countries
- Sharply reduced revenues from tourism
- Massive reversal of private capital inflows
- Reduced access to credit and trade financing
- Reduced public confidence in financial institutions
- Reduced ability to maintain social safety nets and provide other social services, such as health and education
- Increased infant and maternal mortality
- Collapse of housing markets

Despite the responses so far made to mitigate the negative impacts of the crisis at international, regional and national level, there is still a strong need for more solidarity and cooperation to develop a comprehensive and effective global response. This global response should emphasize the restoration of consumer and producer confidence by creating job opportunities and ensuring provision of financial resources for the businesses in trouble. Another major area which needs serious consideration is the containment of the social and human costs of the crisis especially in developing countries. As most of the developing countries have serious fiscal and financial constraints to deal with increasing hunger, poverty and unemployment, more trade and investment opportunities should be created for these countries by avoiding protectionism and providing financial support for sustainable development.

In this context, the Conference acknowledged and appreciated the G-20 London Summit which adopted $ 1.1 trillion program to revitalize the world economy and a larger share of this fund will be made available to developing countries. Considering the specific needs of the least developed countries, $ 50 billion of this fund has been allocated for them to overcome financial difficulties during this crisis. At the individual country level, the Conference recommended that governments should be free to design response packages keeping in view their own circumstances and specific needs. This requires that international financial institutions should improve the lending environment by developing more flexible instruments such as flexible credit lines. In developing policies related to trade, investment and international finance, developing countries should be given a concessional treatment; so that they can take full advantage of available credit and liquidity facilities, capital flows and trade opportunities. Meanwhile, good governance should be emphasized at all levels where measures should be taken to improve transparency, eradicate corruption and strengthening governance at both national and international levels.

In order to contain the effects of the crisis and improve the current situation to facilitate near future recovery in world economy, the Conference recommended that measures should be taken to deal with issues beyond economic and financial sectors; especially those related to poverty eradication, sustainable development, environmental protection, renewable energy, food security, gender equality, health education and sustained economic growth. The development process to recover from this crisis should be more human-centric which creates new opportunities for employment and social security nets to ensure a decent living for all. In this context, the Conference emphasised the need for more cooperation and coordination between the UN development system, regional development banks and World Bank to mobilize additional resources for social protection, food security and human development through all possible means and channels to initiate an early economic and social recovery in developing countries, particularly least developed countries. These international financing institutions should also devise polices and relevant instruments to channel these additional resources to the most needed countries and sectors.

Realizing the importance of trade for economic development, the participants in the Conference renewed their commitment to a more open and fair global trading system. As many developing countries are already severely hit by the decrease in exports revenues, declining trade finance and balance of payment problem, any protectionism measures taken by countries should be resisted and WTO and other relevant bodies should monitor these measures closely and report on protectionist approaches. Efforts should be made to work out an agreement on the Doha Round which will help the developing countries by increasing market access and trade flows. The participants appreciated the commitment related to implementation of duty free and quota free access for the least developed countries, as agreed in the WTO Hong Kong Ministerial Declaration.

In addition, remittances sent by migrant workers are an important source of financing for governments and households in developing countries. Therefore, it should be ensured that migrant workers are not subject to any kind of discrimination and unreasonable restrictions. At the same time, the developed countries donors should fulfil their commitments related to Official Development Assistance (ODA) in accordance with their pledges of achieving the target of 0.7 per cent of GNP for ODA to developing countries by 2015 and to reach the level of at least 0.5 per cent of GNP for ODA by 2010, as well as a target of 0.15 to 0.20 per cent of GNP for ODA to least developed countries.

The Conference also agreed on the urgent need for scaling up the development finance by establishing new voluntary and innovative sources of finances to supplement the existing arrangements. In this regard, the Conference recommended that developing countries should be encouraged to enhance the process of south-south cooperation initiative in accordance with the principles of aid effectiveness. This will provide much needed additional resources for the realization of development agendas and programmes. Developing countries are also suffering from increasing debt and debt sustainability problem, which limit their capacity to adopt appropriate fiscal measures to mitigate the negative impacts of the crisis.

Therefore, lending countries should honour their commitments regarding debt relief. In particular, both donors and multilateral financial institutions are recommended to use financial support instruments like grants and concessional loans as the preferred modalities to ensure debt sustainability. There is ample need for international cooperation to enhance approaches to the restructuring of sovereign debt based on existing frameworks and comparable burden-sharing among creditors. Liquidity in international financial markets is of paramount importance to deal with the financial crisis. The participants of the Conference called for an early implementation of the new general special drawing right (SDR) allocation of $250 billion and an urgent ratification of the fourth amendment to the IMF Articles of Agreement for a special one-time allocation of SDRs, as approved by the IMF Board of Governors in September 1997.

On the other hand, the conference emphasised the fact that the current crisis should not hamper the efforts made towards the adoption of a global response to climate change. There is an urgent need to integrate environmental and social issues into economic planning approaches and the current crisis should be considered as a golden opportunity to promote green economy initiatives by financing and technology transfer to developing countries and forest management. This will support the reduction of greenhouse gas emissions and help poor countries to adapt to the effects of climate change and sustainable use of available resources. The private sector should also be encouraged to take initiatives to promote sustainable environment friendly development at the national level in accordance with the national development strategies and priorities.

It was quite evident that lax financial regulation and supervision has played an important role in the emergence of this crisis. This emphasizes a genuine need to overhaul the existing monitoring and supervisory set up and bring changes with respect to all major financial centres, instruments and actors, including financial institutions, credit rating agencies and hedge funds. In this regard, the IMF should enhance the effective surveillance of major financial centres, international capital flows and financial markets to gauge the full scope of the accumulated risk and utilise its potential to destabilize the international financial system and global economy.

The current financial and economic crisis has emphasized the urgent need for reforming the international financial architecture. There is now a broad consensus on the need for reforming the governance of the Breton Wood institutions, by promoting more fair and equitable representation of all countries to increase the credibility and accountability of these institutions. In this context, the Conference appreciated and welcomed the reform process in the two major Breton Wood institutions, i.e. World Bank and IMF, and recommended that this process should be started by reaching an agreement on participation of more developing countries in these institutions. The World Bank is recommended to introduce a rapid governance reform program with a view to reaching agreement by April 2010 while the IMF should uphold its quota and voice reforms agreed in April 2008 to increase the quota share of emerging and developing economies.

In addition, the Conference emphasised the need for reforms to be made in order to enhance the responsiveness and early warning capacities of these institutions. In this regard, these institutions are also recommended to develop their technical capacities, credit facilities and financial resources needed to assist and complement the efforts of developing countries aimed at achieving their overall development needs. At the same time, the Conference stressed the need for steps to be taken to increase the representation of developing countries in the major standard setting bodies as it has been rightly done in case of the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS).

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