The World Crisis and Its Implications for Emerging and Developing Countries

Opening Session

Introduction

Ramon FERNANDEZ
Director General of Treasury and Economic Policy,
Ministry of Economy, Industry and Employment, France
Chairman of the Paris Club

I would like to wish you all a very warm welcome to this Conference co-organised by the Paris Club and the Institute of International Finance. The objective of this meeting is to contribute to the ongoing debate on the impact of the world crisis on emerging and developing countries and to examine solutions sought by countries in the international financial community. Given the quality of our speakers today, I have no doubt that we shall endeavour to find the appropriate answers.

Welcoming Address

Christine LAGARDE
Minister of Economy, Industry, and Employment, France

I. Welcome to Participants

It is a great pleasure for me to welcome you here today in Paris. I am particularly happy to do so at this symbolic time, mid-way between the April G-20 Summit in London and the next Summit to be held in Pittsburgh in September. We can assess the situation related to the implementation of our commitments within the framework of the various Plans set up.

I would like to thank the Paris Club and its members and to recall that this organisation is not only the information forum with which we are all familiar, but that it is also a place for observing the international financial situation and the impact of the present crisis. I can rely on the experience acquired by the Paris Club for more than fifty years and on its ability to contribute to our collective

thinking process, to formulate a certain number of diagnoses, and to present solutions for coping with this unprecedented crisis.

I am delighted with the participation here today of the Institute of International Finance. Its presence indicates that the international community may also contribute to a certain number of operations, not only in terms of financial regulations but also in performing the intellectual exercise that we are all determined to work on together.

II. The Ongoing Crisis

The present turmoil indicates that we are in a situation of total interdependence. The emerging countries that we are observing today are hit threefold by the crisis. First, exports from these countries toward developed countries, both in raw material and in intermediary goods, have dropped. Second, capital contributions, whether in direct foreign investments or in remittances, are diminishing considerably. Third, these countries are experiencing difficulties in refinancing their external debt. The strength of our concerted action is essential, in the form of financial regulation and in support to the most fragile countries. That is why I would like to convey to you France's resolve to support the international commitment. We shall also examine the ways in which all of the bilateral or multi-lateral actors intend to confront the current challenges.

III. The Collective Commitments

When France held the presidency of the European Union, from 1st July to 31st December 2008, at the time that the crisis was at its climax, France was fully committed. All of the actors took part in the consensus that was reached at the G-20 in London. We set a threefold objective: First, to coordinate the actors according to the means and reaction capacity of each one to the various implemented plans; Second, to sustain the request for the re-regulation of the financial sector; Third, to advocate support to developing countries.

It is our responsibility to measure the impact of the crisis on the most fragile countries, particularly in light of the Summit with the three African countries. When rich countries undergo malfunction in their financial systems, their long-term commitments could be imperilled. As we wish to show solidarity, we are under the obligation to find remedies. We renewed our commitments to the Millennium Development Goals as well as to the debt cancellation objectives. In London, we also decided to enhance the multi-lateral institutions, the International Monetary Fund and the Asian Development Bank, so that they would be well-equipped to meet the crisis. We doubled the efforts of the International Monetary Fund in the poorest countries.

These responsibilities are the major challenges for the Pittsburgh G-20 Summit. We need to assess the situation and take stock of our commitments and of their implementation. We have the responsibility to all of the victims of the crisis to demonstrate that we have truly committed ourselves.

We need to modify our financial regulations, not to have more regulations, but to have better and more coordinated regulations, making the most of reciprocity. Swift measures must be implemented

to double or triple the resources of certain institutions, in order to avoid the development of poverty and the imperilment of development endeavours.

IV. Directions for Innovation

A considerable amount of innovative approaches are on the agenda. The situation having changed, we will need to assess ways of readapting our tools. After many years of long debates, the IMF has implemented its extremely successful “flexible credit line”. Together with my counterpart from Cameroon, Mr. Essimi Menye, we looked into adapting these instruments to low income countries to see how the IMF could be more responsive. The World Bank has offered a framework for the fight against vulnerability. France will contribute one billion euros of co-financing for infrastructure and 160 million euros for the financing of world trade. The European Union is also looking at a mechanism “flex ad hoc”, which will be a contribution to the budget of the most vulnerable countries. The President of the Republic wishes us to commit ourselves to the private sector in Africa supported by entities such as the African Development Bank.

We wish to deal with the aftermath of the crisis in a responsible way, especially in terms of indebtedness. This question pertains to all countries and is essential to those countries whose debt was cancelled within the framework of the Heavily Indebted Pour Countries (HIPC) Initiative. We wish to give those countries access to the resources they need while avoiding a new debt crisis. That is why the IMF and the World Bank together have endeavoured to rationalise everyone’s behaviour in the collective interest.

Our concerted effort to meet the crisis must be an opportunity to have greater international governance, not only in relation to the IMF and the World Bank, but also in an increased role for emerging and developing countries and for shared responsibilities in the management of worldwide goods.

I am happy that the new Financial stability board should be associated with these efforts. I hope that the dialogue between the Paris Club and private creditors will be extended to the new bilateral creditors that are represented here and that such creditors should take increasing responsibilities in the financing of emerging and developing countries.

I hope you have an extremely fruitful conference.

John LIPSKY

First Deputy Managing Director, International Monetary Fund

It is a great honour to be here today.

Since the U.S. recession began in late 2007, policy makers as well as financial market participants have faced a set of unprecedented challenges. Responses from policy makers have also been unprecedented in the form of aggressive monetary policy and exceptional fiscal support.

I. Challenges for Recovery

From today's prospective, it appears that fears of a serious setback have been overcome. After two quarters of sharp contraction, there are positive signs. Confidence seems to be recovering. Indicators of production and demand have firmed.

Nonetheless, there is still significant uncertainty about the pace and timing of recovery. The world real GDP fell in the last two quarters while unemployment rose sharply across the globe.

Notwithstanding the positive developments, forceful policy implementation will be essential to ensure a durable recovery. In our forecasts for the advanced economies as a whole, positive growth will return only by the beginning of 2010. Activity in the advanced economies should accelerate gradually over the course of next year but should continue to be weighed down by bank de-leveraging, limited credit growth, weak growth in household income and the impact of shrunken household net worth.

II. Emerging and Developing Economies

Most emerging and developing countries have weathered this crisis better than in the past thanks to the strengthened policy frameworks put in place over the past two decades. For some countries, sound policies, bolstered by ample global liquidity and high commodity prices, had led to a build up in reserve buffers and had strengthened sovereign and financial sector balance sheets. However, other countries have faced very difficult circumstances, and many have turned to the Fund for support.

One of the positive developments has been the support of our members in developing new instruments such as the flexible credit line, a tool for crisis prevention in a world dominated by securitised finance. However, bank-related flows to emerging economies remain weak and continue to leave some emerging markets vulnerable. A full return to trend growth is unlikely in emerging markets as long as advanced economies are underperforming. We expect output gaps and unemployment rates in most emerging and developing economies to continue to rise through the end of 2010. At the same time, inflation should remain subdued.

III. Near-term Growth Performance in Emerging and Developing Economies

The near-term growth performance in emerging and developing economies will be characterised by greater differentiation across various countries and Regions.

1. Projected Recovery in Asia

The projected modest recovery in 2009 and 2010 is likely to be led by countries, especially in Asia, where domestic demand has shown greater momentum. China and India are projected to resume growth.

2. Output in Latin America

Output in Latin America is expected to contract this year and to recover slowly in 2010. These economies remain heavily affected by declines in exports and tighter external financing conditions. However, prudent macroeconomic management and a recovery in commodity prices should help to stabilise activity.

3. Central and Eastern Europe

The most considerable output declines are projected in central and eastern Europe and in the Commonwealth of Independent States. A reversal of capital flows has punctured credit booms. Emerging Europe has had to adjust to a sharp drop in demand from Western European trading partners.

4. Emerging Africa and the Middle East

Growth in emerging Africa and the Middle East is projected to remain positive this year and to recover modestly in the coming year. African economies are being squeezed by declines in commodity export prices, by sluggish FDI flows, and by a downturn in remittances, but are more insulated from the global financial woes. Prospects for aid are somewhat uncertain.

Middle Eastern oil exporters are using financial reserves to maintain government spending plans.

IV. Risks to the Outlook

1. Risks of Financial Strains

There remains a serious risk that financial strains will persist or intensify further. Tighter financing conditions would deepen the global downturn, intensify adverse real and financial sector linkages, and raise deflation risks. Emerging markets would likely suffer from financing shortages.

2. Bank Capitalisation

The risk of a widespread banking crisis has eased substantially. Nonetheless, bank capitalisation remains a concern. Confidence in the U.S. banking system has been bolstered. European authorities are in the process of addressing concerns pertaining to European banks.

3. Risks of Falling Confidence in Public Finances

The risks of falling confidence in public finances remain a clear concern. These risks stem from dramatic increases in government debt, reflecting the impact of the deep recession on revenues, the fiscal costs of supporting the financial sector, and the stimulus measures.

4. Risks for Economies Dependent on Cross-Border Funding

Economies still dependent on cross-border funding could face increasing difficulties if the current pace of global de-leveraging continues.

V. Prospects for Recovery

1. Possible Better-Than-Expected Upturn

The gradual restoration of market trust and confidence, improving financial conditions and effective policy stimuli could provide for a stronger recovery than is currently expected. Successful efforts to raise bank capital and restore lending could reduce uncertainty and the drag from financing constraints, laying the basis for the resumption of a virtuous cycle. Healing in the financial sector is a key to upturn.

2. Hopeful Signs

The decline in systemic risk has led to improved financial conditions. Manufacturing surveys and consumer and business confidence measures show tentative signs of alleviating economic stress. We see preliminary indications that capital flows to emerging markets may be recovering with net flows to emerging market equity funds entering positive territory and corporate bond markets reviving.

3. Need for a Supportive Stance

However, seen in broad perspective these gains remain relatively modest and their durability remains uncertain. With investors likely to remain cautious over the near-term and with financial conditions still vulnerable to shocks, these circumstances highlight the need to maintain a supportive stance underpinned by a credible medium-term policy framework.

VI. Policy Challenges

1. Three Key Priorities

Looking forward, we can define three key priorities. First, continued forceful policy actions are required to address financial stress decisively, complemented by sustained macroeconomic policy support. Second, credible and coherent exit strategies need to be prepared. Third, donor support to low income countries should be bolstered to enable such countries to attenuate the effects of this crisis on poverty.

2. The Near-Term Focus of Policies

Near-term policies should continue to focus on cleansing bank balances sheets, assessing bank viability, and ensuring recapitalisation where needed, so as to lay the ground for a revival of bank credit. Policy responses need to be coordinated internationally. In emerging and developing countries, the lack of instruments to deal with risks of large-scale corporate failures remains a concern.

3. Supportive Monetary Policy

Monetary policy should remain supportive until a sustained recovery takes hold. Major central banks should continue in their commitments to keeping interest rates low and should also continue to explore unconventional measures to stimulate activity and improve capital flows where appropriate while weighing the benefits against potential fiscal implications.

Emerging and developing countries still need to balance the desire to support demand against the risk of exacerbating capital outflows or deteriorating credit quality.

4. Fiscal Policy to Support Demand through 2010

With economic slack still widening, fiscal policy needs to continue to support demand at least through 2010. The G-20 governments are providing discretionary stimuli. Additional support could be needed if downside risks materialise. Credible fiscal consolidation plans are required to ensure sustainability.

5. Difficult Challenges for Policies in Low Income Countries

The crisis poses particularly difficult challenges for policies in low income countries. Increased donor support is critical to help these countries progress toward development objectives while maintaining macroeconomic stability.

6. Policy Challenges of Exiting from Current Efforts

Eventually, the large-scale government intervention in the economy will need to be unwound, particularly in the financial sector. The timing of exit requires careful planning. Even if exit is still some time off, countries need to develop their plans now.

Roundtable I: Financial and Macroeconomic Factors Underpinning the Crisis

Chair: Daniel COHEN
Professor of Economics, Paris School of Economics / Ecole Normale Supérieure

It is a great pleasure and an honour for me to chair this panel meeting with such prestigious speakers, international financial authorities and representatives of the private sector. The speakers will help us try to answer some major questions. They will help analyse how the financial crisis resulted in such an unprecedented collapse. We thought it would be limited as it was coming from a small segment, the subprime sector, which did not seem to have much consequence on international systems. They will help us understand the causes of such a dramatic breakdown in international trade and will help us determine whether there is a direct link between the crisis and the trade collapse or if the collapse has been due to the standard multiplying factors in Keynesian theory. This may be the first real crisis of the twenty-first century due to the strong interdependency of which we were unaware even a few years ago.

Christian NOYER
Governor, Banque de France

I totally agree with the introduction. Only a few months before the crisis appeared, forecasters were banking on a slowdown of the American economy and a decoupling of the rest of the world. We have seen exactly the contrary, with the first global recession since 1945.

I. Transmission of The American Real Estate Crisis To The Global Economy

The roots of this crisis lie in the American real estate market, starting in early 2006. Adjustment of the real estate market and the correction of prices hit all American States and all segments of the market, which resulted in sharp rise of defaults, not only in subprime mortgages but also in fixed-rate prime mortgages. The real estate crisis was transmitted to the financial sector through the securitisation process. The transmission from the financial sector to the real economy is not as easy to apprehend. The drop in real estate prices led to a negative wealth effect for American households, whose net wealth as a percentage of gross disposable income dropped by 26% between the first quarter of 2007 and the first quarter of 2009.

Another idea is that the drop in stock prices after the Lehman Brothers bankruptcy in September 2008 impacted real activity through an accelerating mechanism *à la* Bernanke, Gertler and Gilchrist. The decrease in asset prices used as collateral meant that it became more difficult to obtain loans. This argument can explain the decrease in credit supply but it is still insufficient to explain the contraction of demand.

Another explanation is the shock of trust. The bad news on financial markets might have led to pessimistic forecasts which became self-fulfilling, with a sharp drop in demand translated into a collapse in industrial production and then in all economic activity. Globalisation and the increased interdependence of economies worldwide, as emphasised by the growth in global imbalances favoured the rapid transmission of recession from the United States to the rest of the world.

Since 2008, emerging countries have been caught into the crisis although their exposure to subprimes and toxic assets was limited. Indeed, these countries were affected by a triple exogenous shock: First, the drying up of international liquidity; Second, the collapse of global demand; Last, the sharp drop in raw material prices.

II. Lessons to Be Learned

Two lessons can be learned from the transmission of the crisis to emerging and developing economies.

1. The Necessity to Improve the Way We Collectively Deal with Crises

The crisis has hit every country in the world including those that had large currency reserves. This protection was therefore insufficient in the eyes of investors who went beyond the mere balance sheet of the public sector. The investors took into account as well private agents' balance sheet and the ability of the domestic financial system to intermediate international capital flows. They placed more priority on the evolution of the amount of reserves than on its actual level. The use of reserves by authorities was therefore partially inhibited. This liquidity crisis indicates that we have to take a new look at our crisis management framework. Public authorities had to deal with the drying up of international private liquidity in emergency, through bilateral, regional or multilateral initiatives.

In the short-term, for developing countries, we need to make up for this sudden drying up of private capital flows. International financial institutions have a major countercyclical role to play. As planned by the Gleneagles commitment, we need to double public development aid to the poorest countries in order to improve infrastructure, develop education, and sustain durably the agricultural offer in emerging and developing economies.

2. Stabilisation-Oriented Macroeconomic Policies Have Allowed To Better Withstand The Global Crisis

Countries do not have the same fiscal and monetary margins for manoeuvre, with different levels of debts, different composition of debts or different public and current account deficits. Even if considerable improvements have been made in developing countries since the 1997 crisis,

traditional sources of vulnerability have not disappeared. Those countries that seem to be more resilient are those that have less financial and structural vulnerability.

Given its amplitude, the crisis we are now experiencing might wipe out a considerable part of the efforts and results that have been recorded over the last 10 years. That is why the efforts being deployed by developed countries to stimulate their economies and by the international financial institutions to increase financing need to have a global dimension and include the poorest countries.

John LIPSKY

First Deputy Managing Director, International Monetary Fund

I very much agree with the key points made by Christian Noyer, so I will limit myself to amplifying a few aspects.

This downturn has been accelerated and has been made more virulent by increased financial linkages globally and by the effects of globalisation.

I. Financial Linkages

Looking back, it is clear that excessive leverage growth created unsustainable asset price rises, reflecting an under-estimation of risk and revealing significant vulnerabilities in the global financial system. In the wake of the severe market disturbance of September 2008, policy frameworks proved to be inadequate to deal with the shock.

Of the many factors that contributed to this fragility, two failures of market discipline have struck me as puzzling and problematic.

The first was the evident failure of shareholder discipline to produce adequate management oversight over the activities of financial institutions. Weak management control over risks in turn produced dramatically adverse impacts on shareholders interests. Looking across the system, this outcome, was not inevitable, as not all institutions pursued the same self-destructive strategies.

The second failure was the widespread phenomenon of institutional investors who, despite fiduciary duties to their clients, nonetheless invested in complex instruments that they palpably did not understand, based on third party recommendations. This response to apparent short-term incentives in defiance of long-term risks became pervasive, even though it represented an abrogation of professional responsibilities.

I find these failures to be problematic because it is not completely clear that regulatory remedies alone can prevent their reoccurrence.

II. Globalisation

1. The Global Integration of Manufacturing and the Modern Global Business Cycle

It is widely held that globalisation, especially the globalisation of trade, is encapsulated in emerging economies producing final goods that are consumed in advanced economies. Examining the data, however, it is apparent that the fastest growing category of international trade over the past few decades has been that of manufactured inputs. Thus, one of the dominant forces of globalisation has been the international integration of manufacturing. This phenomenon—coupled with lean manufacturing—apparently creates a mechanism that transmits final demand shocks rapidly and pervasively around the globe. It will be necessary to consider this characteristic of modern global business cycles in determining future policy frameworks, as it implies a greater need for coherent international actions.

2. The Build-Up of Global Imbalances

The build-up of global imbalances prior to September 2008 did not represent a danger in and of itself, but reflected underlying policies that created risks. The increase in risks associated with rising imbalances undermined confidence, adding to the heightened sense of fragility that followed the turmoil of September 2008.

The premise endorsed by the IMF in 2006 – 2007 was that if global growth were to be sustained and confidence underpinned, a shift in the sources of global growth would be required that inevitably would reduce global imbalances. The broad policy frameworks and programs presented in April 2007 in the context of the IMF-sponsored Multilateral Consultations on Global Imbalances still appear relevant, but at the time were not pursued with the vigour or clarity needed to achieve the intended goals. Today, the anticipated shifts in global growth are taking place in an unhappy way. Once the current downturn is overcome, however, the policies needed to sustain the new patterns of growth will remain relevant.

3. The Necessity for Policies Supportive of Demand Growth in Emerging Countries

Inevitably, the United States, is returning to a more normal rate of domestic savings out of current income. For the past ten years, global growth has depended to an unusual degree on the strength of domestic demand growth in the United States. In the next five to ten years, growth in the United States will depend to an unusual degree on the growth of domestic demand in its trading partners. Policies should be consistent with and supportive of these inevitable shifts. One implication is that the responsibility for sustaining global growth will accrue to emerging countries that previously have been dependent on export growth for supporting their expansion.

In other words, we already possess a reasonable roadmap for the policies needed to face the considerable challenges before us, and it includes the emerging economies as well as the advanced ones.

Jean LEMIERRE
Adviser to the President, BNP Paribas

I will share a few observations seen from the private sector, based on my experience at BNP Paribas as well as at the European Bank for Reconstruction and Development (EBRD).

I. Background of the Storm

In Eastern European emerging countries, the crisis appeared in mid-2007. There were strong tensions in the European bank systems. Russian banks were finding it difficult to obtain refinancing. We did not listen to them. At the time, we thought the prices of commodities and oil would remain high and that the financial tension would be easily resolved. At the end of 2008, we were confronted with two acute shocks, the immense financial shock and the drop in the prices of oil, commodities, and export products. We did not fully understand what was happening. We thought the situation would stabilise by itself, whereas this was just the beginning of the storm. All this is now behind us. Most emerging countries have reacted rapidly and seriously, increasing with the support of the IMF.

II. The Role of Banks

In emerging countries in Eastern Europe, banks have been quite outstanding in their reforms. The joining in the European Union has made it easier for them. Nonetheless, the countries lost sight of the risks. Emerging country banks were developed by using foreign rather than domestic capital.

1. Loans in the Retail Banking Sector

Many emerging countries are faced with a crisis of the quite new retail banking sector. Consumer credit and mortgage loans have developed extensively. Consumer driven growth is necessary to reward the modernisation efforts. Most of the financing has been provided by foreign currencies. Western banks have developed this activity in order to take a market share and have developed loans to private customers in foreign currencies. This development had become the instrument for economic growth in these countries. It was believed that national currencies in these countries would be re-evaluated. However, the debt level was too high as was the income necessary for debt repayment. As a result, the currencies collapsed. It is important to consider the necessity for the IMF and the central bank governors to control or to stop this situation.

2. Debts of Major Corporations in Emerging Countries

A number of major corporations started taking loans in emerging countries. The leveraging phenomenon has not been sufficiently assessed. With the drop in export revenue and in the price of commodities, the debts have increased. There will be a redistribution of assets due to the fact that large companies have to decrease their debts. Faced with this situation the reaction of many emerging countries has been outstanding. They have implemented liquidity policies and have supported their banking sectors.

3. Ways to Deal with the Crisis

a. Retail Banking

We are in the process of seeking an orderly way to deal with the crisis in emerging countries, particularly in retail banking. The only way to deal with this type of crisis is to convene the authorities, particularly the IMF, the European Commission, and the banks. The banks will eventually have to pay. It will be necessary to consult the different partners to determine the amount to be financed by the banks and to set the timing.

b. Rescheduling Large Company Debts

It will also be essential to resolve the question of large company debts in emerging countries. These countries are learning to deal with such situations by means of rescheduling debts. Various state and private organisations are being set up to debate the issue so as to avoid bankruptcies and failures. The process is taking place in the private sector. Improvements will depend on the way rescheduling will be dealt with.

Question and Answer Session

Samir KAMIR, Jeune Afrique

Is the inter-bank market working? Are bank balance sheets cleansed? At what level do banks trust each other today?

Christian NOYER

The inter-bank market is working correctly. Institutional investors are back in the market. In Europe, there is now a new form of concentration. People tend to trust only a few partners. It is not a totally normal situation, but there has been support to banks granted by governments. It has been decided there will not be anymore failure. Most of the difficulties that can be expected are due to the losses that will take place in the form of loans to industrial companies. Our forecasts are therefore quite uncertain.

If the recession continues as forecast in 2009, and if we can recover in 2010, global growth will be restored. Securitised assets have been already dealt with by the banks themselves in a number of countries thanks to government aid. However, the deterioration of the credit portfolio will be unprecedented because the world has never experienced such a recession since the Great Depression. The uncertain factor is therefore the impact of the recession on the credit portfolio in banks. At the present time, we think in Europe that the losses should be covered by bank profits before provisions. We should not take the estimates of global losses as being net losses.

Jean LEMIERRRE

It is really the effect of the round part of the ongoing crisis. We are now going to discover the effect of the economic crisis on financial problems. We could say the same about unemployment which is increasing. We are going to have the traditional mechanisms with the effects on trust and confidence.

Jean MERCKAERT, CCFD – Terre Solidaire, France
(Catholic Committee Against Hunger and for Development)

My first comment: The Minister of the Economy indicated that poor countries are going to be hit by the crisis. The only solution proposed now is for them to obtain more debt. At the end of the crisis we will have poor economies with higher debts. Such a solution seems paradoxical. My second comment: It is all very nice for the Paris Club and private banks to speak about the fate of developing countries. However, in the face of the crisis that started here, would it not be a better idea to speak with such countries?

John LIPSKY

It is not about emerging economies but about the poorest economies. We come on this crisis at the end of considerable efforts through HIPC to reduce the debt burden of the poorest economies. These efforts have greatly improved the conditions of these countries. They are coupled with the debt sustainability analysis shared by the IMF and the World Bank. If new support for developing countries takes the form of debt, the analysis insures adequate concessionality of the terms of new lending. Therefore, there is a clear and concerted effort to avoid laying the foundations for a new round of excessive debt. At the London Summit, the member countries committed to large-scale increases in support for developing countries. At the IMF, we have pledged a tripling, in the near-term, of our concessional support for these economies. These actions have been echoed by other institutions.

Agnès BENASSY-QUERE, CEPII, France

What can the members of the panel say about the euro-zone and its possible enlargement to the Baltic states?

Jean LEMIERRE

I think it is not the right solution. The euro can be an anchor. If a country does not meet the criteria, it should not be in the euro-zone. We do not see that these countries meet the criteria. Observing Latvia, for example, I am concerned of the social consequences adopting the euro would have. When you say the euro is a solution, you are creating expectations that are not good for economic policy. We have to defend the peg as it is today. The IMF and the European Commission have to get mobilised to get Latvia to defend its peg and to give it time to adjust.

Christian NOYER

I have exactly the same opinion. Admitting a country that does not have a level of development corresponding to the other countries in the euro-zone would mean that any imbalance would no longer be perceived. There would be no exchange rate or other way of measuring imbalance. Any necessary adjustment would have to be carried out in real terms, making it necessary to lower wages and social benefits. Entering the euro-zone could have an adverse effect on employment. People could emigrate. The only people remaining in the country would be the old people. Saying that a country is going to enter the euro-zone can look attractive but could be dangerous in the long term. It is in the interest of countries who are still outside not to enter too early as it could lead to unsustainable economic situations.

Daniel COHEN

We thought countries with significant reserves would be able to resist the crisis better. The Baltic States are a specific case. The euro is only one possible solution to a problem.

Can you elaborate on what you think of the reserve issue and on what we should do today if we want those countries to have appropriate instruments? We do not want to send the wrong signal.

Christian NOYER

When you want to give more trust to the market you need either to have accumulated reserves or to have reserves provided by the IMF. You only recover trust if you have a credible and compelling economic policy. If you show the market that you are going to do something about the situation, whether it is through an IMF program or otherwise, the market is going to recover. If you exhaust reserves, you increase worries and fears.

Daniel COHEN

Can you elaborate on what you said about the modern global business cycle? According to this cycle, there is a crisis every ten years. We have had one in the last forty years and now we are having a global crisis. If you follow this idea, this crisis will end eventually, but we will have much deeper cycles in the future with peaks and droughts. What kind of lessons would you draw from that in terms of the international monetary system and the overall coordination of this macroeconomic cycle?

John LIPSKY

First, let me agree with what Christian just said about the problems of the Baltic countries and elsewhere in Central and Eastern Europe and around the globe. If there is a solution, it begins with adequate macro policies and macro balance. Implicitly, no single exchange regime represents a solution to these kinds of problems. The problem in those very small countries is that they are the quintessential example of development based on a colossal run-up in capital inflows and on currency mismatches on the balance sheets of households and businesses. These problems

ultimately are going to require very difficult adjustments. In the case of the Baltic countries, the international community, involving the IMF, the European Union, and other institutions, stands by ready to provide financial support. It is important for the currency regime to be credible and coherent. At the same time, we have seen a tendency in the Region for the floating exchange rate regimes to be pushed toward under-evaluation and the peg regimes to tend toward over-evaluation. In these extremely small economies, the situation cannot be seen in isolation from the Region.

On the subject of reserves, we remain hopeful that this new allocation of SDRs will be approved. It was proposed for 250 billion dollars, a dramatic expansion of the SDR program. Last week, the United States Congress approved the so-called "fourth amendment" of the IMF funding legislation which in itself would double the existing SDR allocations. The distribution is focused on many emerging market economies who were not IMF members at the time the original allocations were made.

As to whether this brusque nature of global business cycles is now inevitable, I would not expect so. The reason is that there were two forms of vulnerability. The first was the build-up of global imbalances which implied a potential incoherence of underlying policies in many important economies and a greater need for policy collaboration. Hopefully, this crisis will give rise to recognition of the importance for more coherence in macro policies that will lead to actions to mitigate future risks. At the same time, it is now obvious that the problems of the financial sector substantially exacerbated vulnerabilities. Those problems are susceptible to substantial improvement by regulatory means.

Roundtable II: Impacts of the Crisis on Emerging Markets: Liquidity Squeeze and Balance of Payment Vulnerabilities in Emerging Countries

Chair: Benoît COEURÉ
Co-Chair of the G-20 Working Group 4
on the World Bank and other Multilateral Development Banks

The issue of the impacts of the crisis on the emerging markets is one of the most important topics that we collectively are to treat today. This subject has been dealt on by the heads of states and the G-20 ministers of finance in the course of their discussions.

It is necessary to look in depth into several subjects related to the situation pervading developing countries:

- First, the way in which instruments decided upon by the international community can assist these countries to face up to the situation. The G-20 has decided that sufficient instruments are to be implemented to assist the countries in coming out of the crisis rapidly.

- We can ask if the G-20 delivers the commitments it made at the London Summit. That will be one of the important themes of the September Summit to be held in Pittsburgh.

- We can examine the possible economic growth in the countries after the crisis.

- It could be interesting to examine the lessons to be drawn from the crisis and whether errors have been committed by the countries themselves or by the international community. We can look at the changes in the modes of functioning and financing. We can see what lessons can be drawn for the international community in particular. We can explore the possibilities in response to the appeal by the emerging countries to sustain their domestic demand and to change the organisation of their economies so that their own consumption is stronger. We will also be able to have an exchange on the instruments of international cooperation in the crisis in Asia.

Sri Mulyani INDRAWATI
Minister of Finance and Acting Co-ordinating Minister for Economic Affairs, Indonesia

I. The 1997 – 1998 Financial Crisis

In Indonesia the current situation reminds us that in 1997 and 1998 we also had a financial crisis. All the memories about the free fall of the rupiah and the massive bankruptcies are with us. In Indonesia there are no bankruptcy laws and no commercial court that can handle such situations. The Indonesian credit rating hit rock bottom. Suddenly, we had to come to the Paris Club to negotiate our debt. It was an extremely painful situation for Indonesia.

II. The Rebound

I am pleased that now, eleven years later, Indonesia is not facing the same situation as back then. The magnitude of the current crisis should not be underestimated. In Indonesia, the change of regime and the corresponding political transition to democracy created a new and challenging environment in the policy making process. We adopted a rigorous and ambitious structure and have continued to implement it over the past ten years. While all of the neighbouring countries and the rest of the world are in economic downfall, Indonesia enjoys robust growth. Consumer confidence remains high. Our stock market has rebound. The rupiah is stable. Inflation is declining. Our deficit figure is quite respectable in comparison with other countries. We are launching a stimulus package to counteract the slowdown of the economy. The banking system is still strong.

The combination of bureaucratic reforms and anti-corruption policies has put Indonesia in a much more positive position. The World Competitiveness Yearbook 2009 has declared Indonesia as the most spectacular mover in the East.

III. The Ongoing Situation

I cannot say that Indonesia is free from the ongoing economic situation. The world crisis has suddenly affected emerging and developing countries like ours. Capital to emerging countries has dropped significantly. The stock and bond markets have been volatile worldwide. This will give Indonesia, as an emerging country, a costly and unpredictable financing for our budget.

The question is not about the willingness of a developing or emerging country to carry out countercyclical measures. It is more about the financing which is becoming extremely difficult and costly.

IV. The Response

Response from the country can be divided into the National, Regional and Global levels.

1. The National Level

At the National level, Indonesia has adopted a comprehensive policy in order to anticipate and manage this crisis.

2. The Regional Level

At the Regional level, Indonesia is working together with ASEAN, with ASEAN Plus Three in the Chiang Mai Initiative Multlaterlisation, and in the bilateral swaps with China and Japan. The sharp decline of global capital will certainly affect access to global financing for us. These initiatives are intended to mitigate the overly dominant dollar dependency which creates high risks for developing countries.

3. The Global Level

At the Global level, efforts have been made at the G-20 by the heads of state, finance ministers and central bank governors. These efforts have provided confidence. The two policy coordination meetings at the leaders' level have created the trust that a responding mechanism to this very complicated and challenging global financial crisis exists. The delivery and the implementation of the policy agreement remain to be seen. We are not complacent or believing that in 2009 the worst is already over. I believe that the volatility and the fragility are over but that the worse is still before us.

Certainly, the Indonesian role in the G-20 is to voice the concerns of many emerging and developing countries. First, this crisis will affect the access to financing for many developing countries. To reduce the risks for developing countries, it is important for the international community to provide a global expenditure support fund designed for the emerging and developing countries that are unable to raise capital or financing for countercyclical measures.

We are pleased that our initiatives to discuss with our bilateral partners as well as with multilateral institutions have provided us with a multi-billion dollar contingency loan. The new instrument which we designed together with our partners provides us with the insurance that if Indonesia is unable to raise financing to a reasonable price level, we will be able withdraw this loan. Indonesia will thereby have a choice of financing which is not subject to the volatility of the domestic or global bonds markets.

V. The Contribution of Indonesia to Other Developing Countries

As the Co-Chair with France in the G-20 working group on multilateral development bank reform, we have increased the capital of the Asian Development Bank. This achievement will put this Bank in a position to intensify its ability to respond to the crisis, especially to the demand for new loans to its member countries.

As a developing country, Indonesia would like to see that the new financial architecture will reflect the right balance between innovation and risk-taking. It should also demonstrate the ability to stay

in line with the financial instruments so that prudent behaviour will be adopted. We are also aware of the importance of disclosure of new information and of the accounting standard.

When the most effective macroeconomic policy is adopted, it will be the responsibility of governments to design adequate fiscal and monetary policies with countercyclical effects. Indonesia may be somewhat different from other developing countries due to its strong fiscal position. Many other countries may not have sufficient fiscal space. They will require considerable temporary international support to relieve the current burden and to secure a sustainable path for the future.

In Indonesia, we are confident that we have adopted the right policy measures. At the same time, our investments in structural reform in the past ten years have provided our country with its strong position.

We must all realise that reform is not always easy. It can be painful in the short term but will benefit in the long term. Indonesia, as a developing country, can demonstrate that we can enjoy the benefit of reform, especially when the global economy presents a very difficult situation.

Isabel GUERRERO

Regional Vice President, South Asia Region, World Bank

For some of the surprises related to this financial crisis, I have used more of my psychoanalytic skills than my economic skills. There are considerable psychological elements to this crisis.

It has been an astounding year: first, due to the intensity of the in shock in September; second, due to the abruptness by which the crisis hit the whole world; last, by the freefall that never seemed to end. I am surprised to hear this morning that there seems to be a consensus that recovery is already here.

I. Global Economic Prospects

It is projected that for 2009, for the first time since World War II, the world will experience a decline in economic output. Global output and global trade are both projected to fall considerably. Capital inflow in developing countries declined last year by around 700 billion dollars. Nonetheless, the worst of the crisis seems to be over. The freefall seems to have stopped. The question now is how quickly the recovery can take place. Although global recovery will take longer, some of the large emerging markets are bouncing back, including China and India.

II. The Crisis in South Asia

1. The Transmission Mechanisms of the Crisis in South Asia

The crisis was transmitted to South Asia by means of three main channels: financial, trade, and remittances.

a. The Financial Channel

The liquidity squeeze and the balance of payment vulnerabilities varied from Region to Region. South Asia suffered less than some other parts of the world as there was less exposure to foreign capital. With the exception of Pakistan, South Asia countries have high domestic saving rates and low foreign borrowings. With the exception of India, the capital markets are relatively insulated from foreign capital.

Within South Asia, India was the most exposed country, resulting in an immediate slump of the stock exchange. Reserves declined. The rupee was depreciated, responding to the pressure in the balance of payments.

Pakistan and Sri Lanka also suffered, more as a result of poor management than to a transmission of the crisis. The access to foreign capital virtually dried out in South Asia.

b. The Trade Channel

In nominal terms, export growth has been negative in India, Pakistan, and Sri Lanka. It has remained positive in Bangladesh, due to the low price of its products. South Asia had been the Region the most impacted by the previous increase in oil prices. The fiscal position and the balance of payments have remained clear, now that oil prices have dropped.

c. The Remittance Channel

Remittances are a very important source of financing in South Asia. They stayed strong throughout 2008. They slowed down in Nepal and in Bangladesh. They remain important for the balance of payments and as a social safety net.

2. The Impact of the Crisis

Economic growth slowed down in 2008 and is expected to continue its fall throughout 2009. The deceleration in GDP has resulted in substantial social costs. India has suffered massive job losses in the export sector. In India, Pakistan, and Sri Lanka, the rise in unemployment is likely to accelerate, due to the continuing downturn in industrial production and in exports. For South Asia as a whole, the impact of the crisis will depend on remittances and on whether a recovery appears in 2010.

3. The Policy Responses and the Prospects for Recovery

The South Asia governments have taken monetary, financial, and fiscal measures in an attempt to stabilise the economy. India, the country which was the most affected by the crisis, has been particularly pro-active. It has passed a fiscal stimulus package. Pakistan has entered an IMF adjustment program. Sri Lanka is currently negotiating a similar program. Fiscal space is now heavily constrained.

South Asia is likely to recover faster than other global Regions as the initial links to the crisis there were not as strong as elsewhere for four main reasons. First, the Region has maintained better external balances and it is not as dependent on capital flows. Second, South Asia by and large has

particularly high levels of domestic savings and of investment rates related to its GDP, which should help in recovery. Third, South Asia attracts much less volatile capital than do other parts of the globe. Last, the slump in exports has been lower in South Asia than in East Asia. If the oil prices stay manageable, South Asia will benefit both in terms of balance of payments and fiscal space.

On the downside, there is not much space left for fiscal stimulus. The ability to finance critical infrastructure is an issue.

4. Role of the World Bank

We are providing fast disbursements, balance of payments, and fiscal support to Pakistan. We are helping India finance its infrastructure. We are expanding social safety nets in Afghanistan, Bangladesh, Nepal, and Pakistan. We are promoting the role of the private sector in recovery in the expansion of the infrastructure. We are working on regional projects to integrate the Region. Finally, we are working on policy dialogue and technical support to bring about the best practices and to learn from South Asia about the response to this crisis.

Bill BRUMMITT

General Manager, International Economy Division, Treasury, Australia

Thank you for this opportunity to present the way Australia sees its role as development assistance provider. In making these comments, I would like to broaden the prism to a longer period than the global economic crisis and to look at the past decade.

I. Asia, a Region of Economic and Strategic Significance to Australia

Throughout Australian history, we refered to the tyranny of distance, being far from the markets of Europe and the United States. With the centre of global economic gravity having shifted to the Asia-Pacific, this tyranny has reversed for us.

Within Asia, we have our three leading export destinations, China, Japan, and Korea. Our exports to China have continued throughout the global financial crisis. Our investment linkages with Asia are deepening and diversifying.

Over recent decades, Australia has strengthened its Regional ties and integrated closely with Asia.

With these expansive economic, trade, strategic and social linkages, it is no surprise that Australia’s fortunes are inextricably intertwined with Asia’s well-being. We have a strong interest to work cooperatively and closely with our neighbours to address the negative consequences of the global economic crisis.

II. The Determination to Be a Good International Citizen

Australia is convinced that a strong, effective international development assistance program is central to its aspiration of being a good international citizen, while it advances our international reputation and influence on the global stage.

Australian development assistance focuses on poverty. Its objective is to assist developing countries reduce poverty and achieve sustainable development in line with Australia's national interest. Working with other partners is crucial for delivering on theses core principles.

III. A Strong Record of Support in Times of Need

During the 1997-1998 Asian financial crisis, Australia offered additional financial assistance to the three countries subject to IMF programs. It is also a founding member of the Asia Development Bank.

In wake of the 2004 tsunami in Indonesia, Australia was quick to act. The Australia-Indonesia Partnership for Reconstruction and Development (AIPRD) is a one billion dollar program to support Indonesia's reconstruction and development efforts.

IV. Australia's Support of Indonesia

Prime Minister Rudd announced in December 2008 that Australia would provide a one billion dollar standby loan to Indonesia. Australia has passed legislation to enable the provision of this loan and it is working with Indonesian officials to finalise the formal loan agreement. This World Bank led arrangement also includes contributions from the Asian Development Bank and from Japan.

Nonetheless, there is no certainty that Indonesia will need to draw on this loan. The Indonesian economy has shown strong resilience during the global financial crisis. The country is likely to experience the third fastest growth among G-20 countries. Moreover, it is not overly reliant on exports.

Australia, as a close neighbour of Indonesia, is struck by how little this strong performance is recognised outside of the Region. It is in stark contrast to the Asian financial crisis and demonstrates how far Indonesia has progressed in the past decade. Credit for Indonesia's impressive macroeconomic performance must be given to many in the Indonesian government. Additionally, during this time of global economic crisis, Indonesia held free and fair national elections.

Indonesia's experience over the last decade shows the power of strong policies and institutions in driving growth and development. The fact that a country can come so far after such a traumatic experience as the Asian financial crisis can be an inspiration to the Eastern European countries that have been extremely afflicted by the current crisis.

Rintaro TAMAKI
Director General of the International Bureau, Ministry of Finance, Japan

Listening to the Indonesian finance minister Sri Mulyani Indrawati, I am reminded of the difficult years after the 1997-1998 Asian financial crisis. In 2001, in this same building, I headed the delegation representing the largest creditor. The gloomy discussion was one of the worst experiences I have ever had in public life. Today, hearing the Indonesian minister's description of the economic policy framework in her country, I am confident that I did not return to this building for Indonesia.

I will speak on Japan's policy related to the current crisis and will focus on the measures to mobilise funds from both public and private sources for emerging economies. Four initiatives are being carried out.

I. Financial Support to the IMF

At the annual meeting of the World Bank last October, the Japanese finance minister stressed the importance of the role that the IMF should play in providing assistance to emerging economies and in taking a flexible approach so as to restore confidence to those economies. The minister indicated that if the IMF required additional resources, Japan would stand ready to supply them. The following month, Japan committed a one hundred billion dollar loan to the Fund. As Japan was the first country to express a bilateral commitment to enhance the financial capacity of the IMF, the implications of its promise were not fully understood, even in Tokyo. The pledge intended to make sure that IMF's resources would be sufficient to meet financing needs during such an unprecedented situation. It also aimed to provide strong backing to emerging markets so that they could strengthen their resilience against financial and economic turmoil.

The call to a flexible approach paved the way to the establishment of the short-term liquidity facility and the flexible credit line for emerging and developing countries.

Japan's commitment to the IMF was shared by other donor countries. At the G-20 meeting in London, the members agreed to the enhancement of the IMF resources.

II. The IFC and JBIC Joint Fund

The Joint Fund between the International Finance Corporation (IFC) and the Japan Bank for International Cooperation (JBIC) aims to stabilise the financial system by means of the banks which have a systemic impact in small and emerging countries. This Fund has already injected deposits in the form of equity investment and subordinated loans to banks in Paraguay and Serbia.

III. Liquidity Support for Asia

This initiative involves The Chiang Mai Initiative Multilateralisation, to be paid in US dollars, and the "Yen swap", in which Japan will provide bilateral swap arrangements of up to six trillion Yen, equivalent to 60 billion US dollars, for possible short-term external financing difficulties.

IV. Support for Samurai Bond Issues of Emerging Countries

This measure is to insure the access of emerging countries to international capital markets. Some emerging countries had access to these markets but are temporarily experiencing difficulty due to the turmoil. In this scheme, Japanese Yen denominated sovereign bonds are issued in the "Samurai Market", the Tokyo capital market, while the JBIC provides a partial guarantee of up to 95%. This facilitates the continued presence of emerging countries in the markets and it diversifies the funding sources for these countries. It may also revitalise the Samurai market and provide a new investment product for Japanese institutional investors seeking a higher return without exchange risks. A JBIC guarantee in Japanese Yen equivalent to 1.5 billion US dollars was made available to Indonesia for two years in February 2009. A guarantee to the Philippines is under discussion.

András SIMOR
Governor, Central Bank of Hungary

I have the ambitious task of trying to cover six subjects in this short presentation.

I. Vulnerabilities of the Hungarian Economy at the Onset of the Crisis

At the time the crisis erupted, the Hungarian economy suffered from high debt both at the state level and at the level of foreign exchange loans to companies and individuals. The economy also had low growth potential, due to the low labour market participation and the high distribution of revenue through the budget due to relatively generous social benefits.

II. How the Crisis Affected the Hungarian Economy

First, the crisis resulted in a dramatic increase in risk premiums and financing costs. Second, it gave way to an increased weakening of the currency. Third, it brought about difficulties for the government to finance its budget deficit. All of these setbacks erupted in one week, shortly after the collapse of Leyman Brothers.

III. The Measures Implemented

The Central Bank increased its base rate by 300 basis points and consequently was able to stabilise the currency. Second, the government implemented drastic measures on the budget. The fiscal effort amounts to 2.6% of GDP for 2009 and 3.8% for 2010, mostly through structural expenditure cuts, particularly through changes in the pension system and cuts in social benefits. Last, Hungary signed an agreement with the IMF and the European Union which has enabled it to increase its reserves and to help it finance its current deficit.

IV. The Early Results of the Measures

Markets are now functioning. There is ample liquidity both in Hungarian currency and in foreign exchange. The current account deficit has diminished sharply. The private sector is able to finance itself from the markets in spite of the modest credit contraction.

The Hungarian economy had gone into deep recession, an inevitable consequence of the pro-cyclical policies prior to the crisis. Unfortunately, we cannot afford counter-cyclical policies during the crisis.

V. Long-Term Issues

Flows can be modified quickly. However, mending balance sheet problems takes time. The government has initiated a front-loaded, long-term fiscal consolidation through structural measures. The banks are carrying out more prudent activities by cutting down on financing from the market and basing their credit extension on deposits. Households need to practice more cautious behaviour.

VI. Long-Term Outlook

Due to the measures implemented by the government, there is to be a sharp reduction in debt within the next five to ten years. The reduced state redistribution by means of a less generous social benefit system will boost potential growth, drive people to the labour market, and create a much more sustainable economic environment in Hungary.

Erik BERGLÖF
Chief Economist and Special Advisor to the President,
European Bank for Reconstruction and Development (EBRD)

I will try to assess the lessons for the whole growth model of Eastern Europe. This process is crucial as we are now making many decisions that will have ramifications for this Region and possibly for other parts of the world.

I. Overview

The last two quarters have been extremely difficult in Eastern Europe. Nonetheless, it took a long time for the global crisis to hit the Region. Although the crisis is deep, we have not seen the traditional emerging market crises involving collapses in both the banking system and the currency.

The variations between the hot spots and the bright spots are extraordinary in terms of the impact of the crisis.

II. Defining the Eastern Europe Growth Model

The Eastern Europe growth model is based on capital flows from capital rich countries to capital poor countries. It stems from nineteenth century United States and is presently reinforced by a powerful outside anchor in the form of the European Union. The model has led to dramatic improvements, particularly in institutions. It has also resulted in a higher level of integration than in other emerging markets. Financial integration has been dramatic, with about 80% to 90% of the banking sector being controlled by foreign banks.

III. Vulnerabilities of the Model

When such a model is hit by a crisis, due to its considerable current account deficits as well as large mismatches of foreign currencies, it appears extremely vulnerable. The model is also characterised by significant private debt build-ups. These vulnerabilities are real, but it is important not to draw the wrong conclusions.

IV. The Initial Resiliency

During the first phase of the global crisis, Eastern Europe was quite resilient. At the outset, emerging markets in general were hardly affected. Only the shock of this crisis, six times the size of a normal emerging market crisis, would later shake the economies of the countries.

This resiliency can be attributed to significant improvements in institutions and to the macroeconomic frameworks and solid fiscal positions of most of the countries, not to improvements in the global financial architecture.

V. The Protections

In an analysis of the factors determining the size of the output decline for a given shock from abroad, it is interesting to observe not only the vulnerabilities in an economy, but also the protections. One protection is the amount of Foreign Direct Investment (FDI) held by a country. The more FDI a country holds, the more it is protected. Inversely, the more open a country may be to the combined size of the foreign trade sector, imports and exports, the less protected it is. Therefore, integration as such is a help. Moreover, with the exception of the Baltic States, the presence of foreign banks in a country results in less vulnerability.

VI. Ability of International Institutions to Coordinate

The lack of a regulatory, supervisory framework to protect this growth model became evident when the crisis hit. Through joint efforts, international financial institutions managed to bring the kind of coordination necessary between host and home countries. An institution such as the EBRD, the largest investor in the Region, has no possibility of diversifying into other regions. With all of its risks in one Region and with one third of its capital in equity, the incentives were strong to get involved.

Many issues remain. An essential question is how to set up the right framework to protect this model. If we cannot put such a framework in place, the model may be doomed as well.

Question and Answer Session

Maria ALEKSYNSKA, Economist, CEPII, France

We have recently seen an increasing amount of foreign direct investments from emerging and developing countries to other emerging and developing countries. In the wake of the crisis, what has been the response to these flows? How do they compare to the foreign direct investments from developed countries in terms of volatility? What are the prospects and implications?

Sri Mulyani INDRAWATI

To answer for Indonesia, the foreign direct investments from developed countries to developing countries are in function of how we can improve the investment climate. It is the highest priority of the government to provide such a climate. We have a significant domestic market debt which in itself attracts foreign direct investments to Indonesia. We also adopted an open and developed investment policy.

The crisis itself will certainly affect the way in which the global economy will be redesigned. A "capital surplus country" is supposed to be a rich country. Nonetheless, a rich country with a reckless government will cause a deficit in the country and with the government. Many ASEAN countries, including Indonesia, have an enormous surplus, because we want to insure ourselves against the kind of experience we had in 1997-1998. These surpluses created global imbalances. We are suddenly not sustainable for the medium or long term. In ASEAN and ASEAN Plus Three, we are considering how to invest this surplus in the Region. In the financial banking sector, the ASEAN countries still need to develop so as to be able to use their own capital surplus in their own Region. This would not only build their own economies but would also help the global economy so that it can correct the global imbalances.

The other difficulty is the development of infrastructure projects. ASEAN is under-invested in this area. This may be the next path for foreign development investments to ASEAN or to emerging countries in general.

Benoît COEURÉ

Is there not an apparent contradiction for emerging market economies to continue wishing to build current account surpluses and reserves as a way to insure themselves against shocks? Would it not be preferable to give more trust to the IMF, further to the enhancement that the G-20 has decided upon for that Fund?

Sri Mulyani INDRAWATI

The relationship between Indonesia and the IMF is very special. A multilateral institution such as the IMF certainly plays a significant role in correcting global imbalances and in enabling emerging countries in ASEAN to invest and to use their own surpluses. To a certain degree, ASEAN countries may distrust the global mechanism designed to protect them from the globalisation risk. Japan was the first to promote the idea of the ASEAN monetary fund. It then became a matter of dealing between the Western dominated institutions, on the one hand, and the emerging strong ASEAN Region, on the other. Many dimensions are involved, including cultural barriers, familiarity, and language. Technically, emerging countries who have accumulated surplus and who have insured themselves against risk are anxious about whether integrating with global institutions would provide them with adequate insurance or reliability. History tells them it is not the case. When they try to protect themselves excessively, they also create global imbalances.

Moreover, Indonesia had adopted a very strong Washington consensus. This policy created great disappointment in the country and is perceived negatively today. Indonesia wants to learn from its own experience and to invest in its own institutional capacity to manage risk.

Eddie BOELENS, Belgian Treasury

One of the consequences of the financial and economic crisis is that poverty has grown everywhere in world. For the first time more than a billion people do not have enough purchasing power to buy necessary food. Unemployment is rising throughout the globe, including in the United States. In the measures we wish to adopt against the crisis, are there specific strategies at local, national and regional levels to fight against poverty?

Erik BERGLÖF

What you are saying is absolutely true. In seeing the social and poverty outcomes of this crisis, you see how vulnerable you are in this kind of situation. We see the programs that countries are forced to implement. In Latvia, for example, the government is considering closing down hospitals and raising the school age of children in order to get its economy back onto a sustainable growth path. These are extremely high costs to pay for the lack of a necessary regulatory framework. It is essential to examine how we can protect ourselves in the future.

Isabel GUERRERO

Employment rates do not have the same impact on poverty in countries such as the United States as in countries that do not have natural safety nets. In countries without them, we have been working on the implementation of safety nets that have been proven over time. This is being carried out in Pakistan and in Nepal. It does not resolve the whole problem but it does help with the poorest.

Roundtable III: New Financing Challenges in Low-Income Countries

Chair: Patrick GUILLAUMONT
Professor, Centre d'Etudes et de Recherches sur le Développement International (CERDI)

This afternoon roundtable is particularly important because we are going to discuss those low-income countries which have not yet been put in the category of emerging countries. I do not wish to offend the Minister of Finance from Cameroon, because Cameroon is no longer defined as a low-income country.

For these countries the crisis at its onset was considered less important than for emerging countries, due to the fact that they were less fragile from a financial standpoint. However, when the financial crisis was transformed into an economic crisis, low-income countries, as a result of the drop in the price of raw materials, the transfer of remittances, and the drop in foreign investments, became even more vulnerable than emerging countries. Due to the extremely severe economic and social consequences of the crisis in low-income countries, the negative shocks can have long-lasting effects in the economic and social fields.

In order to respond to this crisis, the international community seems to be quite mobilised, as are the countries that are directly concerned.

We will be dealing with the following issues: The response that the international community has been able to bring to this crisis; the efficiency of the instruments provided by the international community to counter shocks in low- or moderate-income countries; the opinion of these countries as to the use of the exogenous shocks facility of the IMF or the flex of the European Commission; how such instruments can be activated or reactivated; how the Bank reacts to sustainability; and how these countries will be using resources from multilateral institutions.

Over and beyond these issues, we shall endeavour to see whether the response to the crisis in low-income countries may be an opportunity for a more sustainable reform aiming to enhance capacities for managing instability.

Last, a crucial issue is to examine the possibility of taking the vulnerability of low-income countries into account in aid allocation.

ESSIMI MENYE

Minister of the Economy and Finance, Cameroon

Allow me to thank the organisers of this conference who enable us to present some salient features regarding Cameroon.

I. The Twenty-Year-Old Crisis

The case concerning Cameroon is quite specific in so far as we did not discover the crisis in 2008 or 2009. Cameroon has been experiencing a crisis for the last 20 years. That is why we have had to undergo a structural adjustment for so long.

When you are already tired, nothing much changes. You remain tired. We are tired as a result of the 20-year-old crisis. We were assisted by partners within the framework of the multiple structural adjustment programs. These measures have not been without negative effects and damages. Today we have a road network which is not functional because the structural adjustment was focused on having a handle over the state budget in managing the Treasury in order to stabilise the macroeconomic balances. Nothing was done to improve agriculture or education.

We have constraints in terms of infrastructure. We do not have enough electricity because we have not developed hydroelectric power plants sufficiently. Cities need to be rebuilt. After several years of reform, we crossed the completion point in April 2006. The efforts of the Paris Club led to the cancellation of our debt. The different funds allowed us to reduce our external debt. Thanks to the members of the Paris Club, we can start to lift our head up. We had started to implement reform to get the economy to recover. The crisis coming from America then reached our country.

II. Plans for Coming Out of the Crisis

It is indeed a program similar to the Marshall Plan that would be needed to come out of this crisis. However, the necessary resources do not appear. The question was also raised as to whether a country should go back into debt. For us, it is not a question. We have to. We do not know if there will be additional financing. The requirements we have can only be met if we can mobilise. We need a minimum financing threshold which cannot be obtained under the current conditions. We have been asked to seek a concessional investment, but we do not see where it can be obtained.

Partners such as the European Union provide assistance, because the EU today is the main provider of resources to rebuild the road network. However, we need additional support. The African Development Bank has just signed a new credit agreement for a road going from Nigeria to west Cameroon. In the efforts of economic recovery, the closeness with Nigeria remains an asset for Cameroon, as Nigeria is a potential market. We will set this idea in the next few months, so that the investors will be aware that the Cameroon platform can be a fruitful workshop for selling to Europe and for developing the fraternal relations that unite Cameroon and Nigeria.

III. Vision of the Government in Terms of Recovery

Given the difficulties that we have experienced over the last two decades, we cannot overly spread out our priorities.

1. Strengthening Agricultural Production

This is one of our prime priorities as we want to be sure that everyone gets to eat. At the beginning of last year there were numerous riots, including in Cameroon, because of the rise in the price of foodstuffs. We have a soil and a climate that should allow us to increase production considerably. The market exists. In case of surplus, we can sell to the neighbouring countries or to Europe.

2. Strengthening the Road Network

The road network is what is going to truly allow for the circulation of agricultural produce and other goods as well as people.

3. Education

The vision of the government is to make Cameroon an emerging country within the next fifteen years. In order to do this, by 2020 we need to produce a minimum of 10,000 engineers per year. That is what will make Cameroon an attractive platform for investors. Even if administrative and fiscal issues are resolved, if a country does not have qualified workers in sufficient numbers, the investors will not come with their technologies to produce in Cameroon.

IV. Welcome to Cameroon

Cameroon is the only country in Africa which has all climates. It also has desert, mountains with snow, and dense rainforests. For those of you who like this, you are most welcome to Cameroon.

Dr. Paul A. ACQUAH

Governor, Bank of Ghana

Africa has been hit by the crisis. The African continent is a heterogeneous group of countries. Therefore, the impact of the crisis has been quite variable. However, all of the countries have suffered from one channel or another. The commodity channel has perhaps been the most difficult for all of these countries.

In Ghana, one commodity, cocoa, is defying gravity. Prices, together with output, have remained firm. Exports are doing well. Gold has stayed quite strong. On the export side, as far as the traditional commodities are concerned, the country is doing quite well.

This crisis follows the heels of the energy and food price shocks that also affected a number of African countries. During the last quarter of last year and the first quarter of this year, there was a lot of volatility in the exchange markets of most of these countries. I have been following a group of countries that have been qualified as the frontier economies, including Tanzania, Zambia, Nigeria, and Ghana. We can see a commonality of experiences. There were major depreciations in a number of these countries. They opened up their current capital account and were therefore susceptible to these reversals of capital flows.

My personal concern is that a number of these countries had been very successful in implementing reforms. This crisis is risking all the gains that have been made. We have to bear in mind that the long-term goal is development. In the short term, all of these countries clearly need the balance of payments and budgetary support, currently being provided effectively by the IMF and the World Bank.

It has been asked whether the IMF can be trusted. Whether it be a question of trust or of the capacity of the IMF and World Bank to deliver insurance to cushion these countries against crisis, financing has been a challenge and will remain so for a number of reasons. The fiscal space has been exhausted. In the short term, it is difficult to mobilise domestic savings. At the same time, there are pressures on fiscal space arising from the revenue losses associated with commodity price declines. We then have to revert to the conventional traditional financing model, that is, the support by the IMF and the World Bank by the donors, including debt relief. It is necessary to obtain the right balance in financing, by bringing private capital flows into the model.

I was thinking of a collective action clause which would provide for the incorporation of private capital flows into the traditional Bank-Fund-Donor arrangement. Unless we obtain private capital flows into the equation, we will not be able to meet the infrastructure requirements that Mr. Essimi Menye mentioned. The issue is therefore how to modulate the model of non-concessionality and debt sustainability in order to derive a model that will still open the access of reforming countries to international capital markets. That is the challenge.

Donald KABERUKA

President, African Development Bank Group (AfDB)

Many African countries have been able to face up to this crisis. This is due, in part, thanks to the assistance of the Paris Club which has strengthened the financial capacity of some of these countries.

Last week we signed one of the biggest loans in the history of the Bank: 1.5 billion dollars to Botswana. I cannot find a more convincing case of the impact of the crisis than this one. Here is a country that has been held up as an example of good management, good politics, and good governance for almost three decades. Just the same, it was the first country to be affected by the crisis. This case is symptomatic of how often we make errors in our evaluations of Africa.

People tend to point out that Africa has 53 countries, all different. However, if we take Lesotho as an example, we see that the country, one of the poorest on the continent, is almost approaching recession conditions. This is basically due to the fact that its economic level depends considerably on the activities of South Africa. The South African economy, quite open, is now in recession. Therefore, deliveries to Lesotho from the South African Customs Union have declined. There is an enormous gap in revenues. A country like Lesotho is suffering because of the downturn in South Africa.

We should not be analysing what is happening by taking African countries individually. International aid is allocated on the basis of country performance. Yet, the countries are interrelated and the problem covers regions and even the whole continent.

This reality has implications for responses. We cannot respond only to the low-income countries and leave aside the challenges of mid-income countries who are the engines of growth.

The African continent presents countries of different economic structures, related to the structure of exports, the dependence on external flows, and the capacity to act as determined by reserves and fiscal space. These aspects are extremely important in deciding upon our response.

At the Bank, we agreed to the following:

- First, to use our convening power to bring African countries together, so as to ensure that we do not learn the wrong lessons from the crisis.
- Second, it is important to say that our voice matters in the G-20 and in the G-8.
- Third, we need to decide how to respond. We have tried to customise our responses. For low-income countries, we will face the challenge of having limited funds to allocate. We need to use them anticipatively or innovatively.

We have brought resources to countries, accelerated their deployment, and innovated the instruments. Funds in multilateral development banks such as ours, become depleted. We are in discussions with other countries to be able to anticipate future replenishment.

In the last fifteen years, the way African risk has been repressed has been unique. There was a chronic under-estimation of Africa's assets and over-estimation of its risks. There was more inflow than private investment. In times of crisis, we do not want to become heavily dependent on Official Development Assistance (ODA). We need to continue attracting investment and try to use our private sector window. It is therefore important to pursue infrastructure and to keep improving the business climate. Programs in public aid are therefore critical.

We think this crisis will end sooner or later, and when it does, we should not see the Africa of the 1960s or 1970s, but an Africa that should take off from when we began attracting investment.

It is essential to strengthen the resources of the African Development Bank and other regional banks, not only for public aid, but for the leverage effect on the private sector activity. I hope that the Pittsburgh Summit will be both the Summit of implementation but also the Summit of the poor countries.

Ottaviano CANUTO
Vice President, Poverty Reduction Management Network, The World Bank

I shall focus on two subjects, the review of the debt sustainability framework and the World Bank response to the crisis.

I. Review of the Debt Sustainability Framework

The G-20 communiqué requested the World Bank and the IMF to review the flexibility of the Debt Sustainability Framework. It is high time to perform this exercise, particularly because the channels of transmission of the crisis are all reaching low-income countries. We expect some deterioration in the debt sustainability indicators, due either to the fall in exports and in government revenues or to the increase in debts. In some countries, rollover and accelerated repayment may become an issue. We are likely to observe the implementation of fiscal stimulus packages which may affect debt sustainability dynamics.

Debt sustainability will depend on how long the crisis will last. A short-lived crisis will have a small effect on sustainability as the relevant indicators are of a long-term nature, that is, for twenty years. If the crisis is prolonged, it will have a more lasting effect on debt sustainability.

The requests coming from low-income countries, supported by some stakeholders, express the view that the current Debt Sustainability Framework does not take sufficiently into account the impact on growth of debt financed investment. Moreover, the requests show concern that, as it is today, the Debt Sustainability Framework is highly pro-cyclical.

The staffs of the IMF and the World Bank see value in exploring these concerns. However, we should keep in mind that the Debt Sustainability Framework is simply an analytical tool. It exists in order to assess a country's indebtedness and the risk of default. The place to search for dual flexibility would be in each institution's non-concessional borrowing policy.

Some aspects of the Debt Sustainability Framework may need to be updated:

- The investment growth linkage. We can explore whether we can grant more specific guidance to country teams. We are examining the possibility of using an operational tool to model this linkage.
- Reducing the so-called "threshold effect" coming from the Country Policy Institutional Assessment (CPIA). We use this indicator of the quality of policies in our institutions in order to calibrate the results coming from the mechanics of the debt, because of the long-held evidence that the quality of such policies matter. The problem is that we have a short range of score levels, which sometimes created large effects in the whole estimated trajectory. We need to give more granularitiy to the range of CPIAs.
- Remittances. These were not considered in the current Debt Sustainability Framework in the definition of the thresholds. The Debt Sustainability Framework as it is possibly underestimated the country's capacity especially in cases where remittance was considered an important source.
- Updating the discount rate, currently at 5%. The Framework stipulates that this rate should be adjusted whenever the six-month average US dollar commercial interest rate deviates from its level

by 100 base points for a period of six months. We are going to discuss the rationale of this rule and the implications of lowering the discount rates and the possibility of revising the rule in the light of the current experience.

- The treatment of debts in state-owned enterprise. We probably will suggest ways in which more flexibility and granularity can be added to the analysis and make the Debt Sustainability Framework more solid.

- We shall bring this paper to the Board of Directors of both institutions by the end of August. Provided it is approved by both Boards, we will be able to show the results and answer the questions raised at the G-20 Meeting of last April.

II. The World Bank Response to the Crisis

At the onset of the current crisis, many analysts thought mistakenly that it would not hit hard low-income countries as it was considered to be a financial crisis derived from sophisticated practices in financial markets. The irony is that in relative terms the crisis hit the low-income countries even harder, particularly in the channels of trade, affecting fiscal revenues and investment decisions. Low-income countries have also suffered substantially from banking introspection.

The task is even more difficult because of the sequence. Although we may be seeing possible signs of an upturn, it will take quite a bit of time for any recovery, and will take a long time to have the low-income countries on track for recovering growth. The paradox is that this is taking place after a decade of substantial improvements in the quality of policies in low-income countries.

The International Bank for Reconstruction and Development (IBRD), the World Bank division that deals with low-income countries, decided to nearly triple its lending in Fiscal Year 2009, from 13 billion dollars in 2008 to approximately 33 billion dollars. We are using the limit of our lending capacity. Forty-five percent of the Fiscal Year 2009 loans have been made through disbursement policy loans, that is, cash in return for policy requirements.

International Development Association (IDA), our concessional arm, has resourced to make commitments of up to 42 billion dollars over Fiscal Years 2009 to 2011. Our current projections are showing that for this year, the IDA commitments are rebounding, significantly. We are projecting commitments of a historical high of around 14 billion dollars. Clearly, the incremental demand for IDA resource has come as the crisis has accelerated. We are anticipating frontloading any resource we can obtain. If the crisis lasts, we will need ammunition for the near future.

Under the umbrella of the Vulnerability Framework, we have set up several target initiatives to protect the most vulnerable: the Food Crisis Response Program and the Rapid Social Response. We focus our work not only on the infrastructure but we also try to reinforce all existing social protection networks. We also act as a catalyser to bring in private investors. We have dedicated attention to small and medium-sized enterprises as well as to bank recapitalisation.

We strongly believe at the World Bank that, for understandable reasons, G-8 and G-20 focused on the financial crisis and on aspects relative to advanced economies and emerging markets during this first phase of the crisis. Of the substantial amounts of resources that have been pledged, most cannot be used by low-income countries, especially those that face barriers for borrowing. We deem

that it is now time for the international community to turn to the issue of low-income countries and hope that this plea will be heard at the following meetings.

Klaus RUDISCHHAUSER
Director of Directorate C. (ACP I – General Affairs)
Directorate General Development and Relations with African, Caribbean and Pacific States, European Commission

I shall say a few words on behalf of the European Commission and, if you allow, I shall speak also for the European Union as a whole. We should not forget that we are the largest donors worldwide to developing countries, in particular when it comes to grant financing.

I. The Larger Context for Developing Countries

It is important to see the larger context at the time developing countries entered the current crisis. Developing countries did not simply go into this crisis. They were already in crisis. We are presently implementing additional funds for agricultural in the order of one billion dollars following last year's price rises in agricultural and commodities. At the same time, as the European Union, we are implementing a short-term package of 200 million dollars to those countries who are the most affected by the food price rises last year. We are therefore still in the process of addressing the last crisis.

We do not belong to those who thought that the crisis would not hit the least developed or low-income countries. We had already analysed the vulnerability and impact of the crisis which enabled us to come out with the first warning signals.

The ACP (African, Caribbean and Pacific) group of countries have a special framework within the European Union, the Cotonu Agreement. The European Development Fund (EDF) is the main instrument for providing aid for development in these countries.

II. The Commission Communication Supporting Developing Countries

After the G-20 in London, we came out with a communication as to how to address the crisis in these developing countries, listing 28 complete measures as the European Union as a whole.

We pointed out that we have to make progress on economic development and on aid effectiveness, that we have to stimulate employment, revitalise agriculture, invest in green growth, address climate change, and stimulate trade. Additional money is only part of the reply if we want to help the developing countries to face this crisis and not to lose out on everything they have gained in the last 10 years.

In the European Union, we have so far managed to increase official development assistance (ODA) every year. However, this assistance is at risk. Given our commitment to respond actively to support our partners the crisis must not be an excuse to water down donors' aid commitments. A significant effort will be needed to ensure fulfilling our aid commitments, of which the current increase is falling short. Moreover, in the short and medium term, we have to focus our assistance on those most vulnerable and least resilient to the crisis, as they will not be directly positively affected by further lending or by longer term recovery measures. We therefore insist that the ODA targets be kept.

III. The Vulnerability Flex

I would like to concentrate today on one of the 28 proposals in the Commission Communication, the “Vulnerability Flex”. We attributed this name to this measure because we have an existing instrument for compensating export losses in times of crisis, called “flex” which is not adequate in this crisis. We therefore added a second, counter-cyclical instrument.

The Vulnerability Flex is designed to mobilise 500 million additional euros in fresh money to address the immediate consequences of the crisis in the most vulnerable and least resilient countries in the ACP Group.

The aim of the Vulnerability Flex is to be timely, co-ordinated, targeted, and counter-cyclical:

- Timely, as the first disbursements, as well as the impact, must be already this year and then in 2010.
- Co-ordinated, as we need to ensure complementarity of the Vulnerability Flex mechanism with the instruments provided by the World Bank, the African Development Bank, the IMF, and bi-lateral donors. The need for this tool is particularly important in those countries that do not have sufficient access to external aid instruments and/ or foreign and domestic financing. We are aiming to maintain pro-poor spending by closing the residual financing gap to the extent that it cannot be closed by the IMF and other lenders or to the extent that the countries cannot borrow more.
- Targeted on the most vulnerable countries, because we do not have the financial resources to carry it out in all countries.
- Counter-cyclical. It has to intervene this year and next year. All other actions are medium- or long-term and therefore do not have immediate impact.

The most important aspect of this instrument is grant finance. It is therefore complementary to the lending which is offered by the various institutions as part of the global response. Except for some increases in ODA from bilateral donors, this is so far the only instrument in which grant finance is mobilised in addition to addressing the crisis in the least developed and most affected countries.

The Vulnerability Flex is not a stand-alone instrument. It is part of an overall approach and has to be coordinated with all of the donors. We will re-orient the country strategies to address the impact of the crisis and will continue to implement measures supporting the real economy in the areas of infrastructure, agriculture and green growth as well as stepping up efforts to enhance aid effectiveness.

The Vulnerability Flex mechanism demonstrates that the European Union partnership with the ACP countries is a real one and that it works, because we are capable of reacting in time to the crisis. These are trying times for our partner countries. Please be assured that the European Union will do all it can to fully meet its responsibilities

Question and Answer Session

Marc RAFFINOT, Professor, Université de Paris Dauphine

My first question is for Mr. Acquah. Ghana borrowed quite a significant amount on international financial markets at a high interest rate in order to finance infrastructure. How did you justify this decision in relation to concessional loans?

My second question is for Mr. Canuto. In the items you mentioned about the Debt Sustainability Framework, you did not mention the thresholds. Why do you want to keep thresholds in the Debt Sustainability Framework while they are not relevant? Even at the World Bank, nothing indicates that you should comply with one threshold more than another.

Paul A. ACQUAH

It is true that Ghana issued its sovereign bond in November 2007. It was quite successful. If you look at the coupon rate at the time you would not have thought it was too expensive. The proceeds of the bond had been earmarked for infrastructure development. The motivation was access to the capital market. During 2007 and 2008, much of the proceeds were channelled to infrastructure development. The sudden shock in energy and food prices complicated the fiscal problem. In 2008, fiscal expansion was quite steep. The combination of electricity related expenditure, the deliberate execution of the infrastructure program, and the energy shock resulted in a fiscal deficit partly financed by the sovereign bond and privatisation proceeds. In the process, there was a lot of stimulus to the economy to the point that the GDP growth reached 7.3%. The offshoot is that we are left with budget and current account deficits. The impact of this crisis is not on commodity side. The new government has taken the bull by the horn with a fiscal consolidation program that is being supported by the IMF and the World Bank.

Otaviano CANUTO

The review will also update the parameters that define the threshold. I agree that the threshold should always be seen with a grain of salt. It always has to be treated with judgement.

Samir KAMIR, Jeune Afrique

I have two questions for the president of the African Development Bank. First, can the African Development Bank assess the African risk in an independent fashion and give us an idea of that risk that would be specific to the African Development Bank? Second, every time the Bank lends public money, what is the contribution of the private sector and what is the leverage coefficient?

Donald KABERUKA

In speaking of risk, there is a question of understanding it and there is a question of pricing it. There are agencies for assessing it. People have said that there is a perception that Africa is always a high risk. There is a chronic under-estimation of our assets. Over the past ten years, we have seen a change in the understanding of risk, and in the way it is being priced. South African companies have come to understand Africa better when they move north. We have no intention to have a risk assessment model. It would have no credibility. Our role is to bring in the investors. We can do so because we understand the risks and the best practices needed. We also work with the governments to improve the business climate. We know the issues.

From the floor

I do not know whether it is an under or over evaluation of risks. The crisis financing will be simplified because the capital will be based on the fundamentals of the country rather than on the basis of a yield. Do you believe that such financing would actually benefit the African continent given the fact that countries before the crisis have progressed considerably in the macroeconomic stabilisation and restructuring of their economy?

Donald KABERUKA

The perception of the fact that policies changed brutally was harmful to Africa. Some countries had had an excellent performance for 20 years, such as Zimbabwe. Southern Africa suddenly changed policies. Another well-known example is Kenya. When policies change overnight, there are difficulties for many investors. We are trying to work with many of our governments. For many countries, particularly those rich in mining resources, investors come to us and we analyse the risk-related elements together. We have already seen an increase in demand. I am convinced that this kind of financing will be useful for our countries.

ESSIMI MENYE

The answer is a long one. Today many investors are interested in the financial resources. They are not interested in cultivating sweet potatoes if there is oil and other mineral ores and they know what there is. They are concerned about political risks and legal security. Looking back in history, you see there are very few situations in which the states do not respect the conventions signed with investors. A reversal of trend is what is awaited so that investors can start getting an interest in agricultural products, for example.

To come back to the ratings, I believe they are quite subjective. In the past two years we have seen that in spite of the good ratings, the crisis came within agencies that were rated triple A's. We must always cautious when it comes to the reading you make of all these evaluations. They have an intrinsic value but are often dressed with considerations that the governments themselves do not have a handle on. They are always contaminated by perceptions and views that come from elsewhere.

Internally, we do not have the capacity in human resources to reassess all these considerations. The evaluation would require several years of work as well as important financial resources so as to put together multidisciplinary teams able to give viewpoints. For some projects to be financed, you need certain signatures. If you cut yourself from these operations, your country becomes fragile with regard to major investors. Cameroon has sufficient reserves, and we have been in negotiation with investors who believe that their point of view should have primacy, because that would allow for financing to come. WE have the biggest hydro-electric reserves after Congo. We plan to set up hydro-electric power plants in order to provide energy for Cameroon and also for Nigeria. We need good joint ventures with the investors of the electrical sector. It is necessary to find the basic resource to enable us to launch the study for the design and construction and the financing to carry out the investment.

Donald KABERUKA

As a footnote to what I have been saying about the predictability of policies, I think that when there are good governments, transparency in policies, and participation by the public, poor policies will be brutally reversed. When policies become successful, you have the support of the public for the maintenance of a policy regime that will give insurance to the investors.

Freddy MULONGO, Réveil.FM Radio

What is the position of the African Development Bank with regard to the Chinese presence in African countries who come with a win/win policy? They come to seek raw materials and they come with fresh capital.

From the floor

On the basis of what was said this morning, we see that Africa has a considerable amount of savings. The problem we have is that a large part of these savings go to the developed countries and are easy to transform. Conclusions from a regional development bank try to explain how the priority should be internal banking reforms in order to have a banking system that is relatively solid and that allows a country to keep its savings and to re-inject them into its own system.

Donald KABERUKA

Two years ago, our annual board meeting was in Shanghai. China is a very important partner for Africa. Many African countries benefit from investments, infrastructures, and railways. In this crisis, everybody believes that if there is a recovery, it will benefit everybody, including Brazil, India and China. Contracts should be well-negotiated to the advantage of the two parties, but also within the framework of debt sustainability. I think we should strengthen our negotiating capacity. Our Chinese colleagues are very interested in African raw material. We must give them added value. May I also remind you that China is part of the IMF, the African Development Bank, and the World Bank. We have a framework of discussions for all these issues.

ESSIMI MENYE

I would just like to add that China has just agreed to loan some money to the IMF. China is lending to everybody. If China comes to seek raw materials in Africa, it is because the Europeans and Americans have displaced their companies into China. A few years ago, the Chinese did not have so much technology or investment. In a dynamic that has not benefited our countries, our traditional partners have chosen China rather than Africa. If even 10% of these investments had come to Africa, we would be talking about something else today. We realise today that Europeans went to strengthen China so that China would come to Africa for raw materials.

Like Europeans, we need Chinese products. The problem is the proper use of the loans that we obtain. Good governance is governance that allows for the production of the best possible results. For the question of banks, it is the same. Tomorrow we will see Chinese banks coming to us because French banks only do retail banking. They do not finance. It is true that there are risks in SMEs. There is also a cognitive process in which it is necessary to educate banks. You mentioned the problems of poverty. There are a few Africans who take their money and invest it in Europe because the yield higher. We had thought that the arrival and existence of foreign banks was to be a driving force for construction. Over the last twenty years, we have always been told the same story: Leave space for the private sector. We have closed our public companies or we have sold them to the private sector, because we thought the private sector would be the engine of development.

Closing Session

Hung Q. TRAN
Counsellor and Senior Director, Capital Markets and Emerging Markets Policy Department, Institute of International Finance

We are now coming to the end of a very long and but extremely interesting day. We have learned a lot. The presentations and interventions have been extremely rich and wide-ranging.

Here are six key points that I find important to take away from this conference:

1. Many of the speakers designated the crisis we are experiencing as the first crisis of the twenty-first century. It is marked by its severity. The spread and contagion of the financial crisis stemming from the major international financial centres were driven by the inherent dynamics of the global financial market itself. The crisis became linked to the real economy via a dramatic collapse in world trade at an unprecedented level.

   Both of these aspects expose the dark sides of globalisation.

   However, the glass is half full. John Lipsky from the International Monetary Fund says that the worst is behind us. We are in a healing process, even though the timing and the strength of recovery is uncertain.

2. The crisis revealed many important weaknesses, gaps, and even failures in the international financial system, in the financial institutions and markets, and in their regulation and supervision.

   These weaknesses and failures ranged from the exotic – the growth of complex products and complex exposures and the growth of leverage to an unprecedented level – to the downright mundane, such as the effort to insure the quality of lending and underwriting mortgages that go into structured products. It also involved more macro weaknesses, such as the pro-cyclicality of many rules, regulations, and accounting standards that unwittingly amplified the downturn and produced the crisis.

   The crisis revealed serious problems in the international framework for crisis prevention and resolution. Much needs to be done to overcome those problems. Global financial regulatory reform must be adopted seriously.

   However, in this context, Christine Lagarde's motto: "Better regulations, not more regulations" is fitting. We in the private sector share and support that view and we, on our part, besides improving our own practices and improving the shortcomings that were revealed during the crisis, have actively engaged with the public sectors and the regulators in devising an appropriate response and reform so as to insure that this kind of crisis will not happen again.

In this regard, we share the idea expressed by many speakers that we need to learn the right lessons, to avoid learning the wrong lessons, and to avoid "throwing the baby out with the bath water."

3. On a more macro level, the crisis, both in the financial sphere and in the economic sphere, raised questions about the appropriate model of sustainable development and growth for many emerging market countries and developing countries. John Lipsky showed the differentiation of the growth prospects and the performances of emerging market countries.

   Asia, having learned well the lesson of the Asian crisis 11 years ago, and having had good policies and the necessary resources to stimulate domestic demand, will probably emerge from the crisis stronger.

   Latin America is more dependent on external trade and suffers from the collapse of world trade. However, good policies in many countries cushion the blow to some extent.

   The worst performers are in the eastern European countries in the Commonwealth of Independent States (CIS) which became extremely dependent on external capital and coupled that with the serious currency mismatches on the balance sheets of their corporate and household sectors.

   These differentiations lead me to conclude that at least two lessons can be learned. First, going forward, a model of more balanced growth may be preferable than excessive dependence either on external trade or external capital flow. Second, good policy pays in good times, and more so, in bad times.

4. Global imbalances in the sense of huge current account deficits in one country, the United States, and big current account surpluses in another country, China, and in other countries in between, have been viewed as the key threat to stability. The U.S. current account deficit collapsed within two years from 6% of GDP in 2007 to 2.5%. of GDP estimated for this year. However, these imbalances may have been replaced by another form of imbalance, i.e. fiscal deficit in major advanced countries. The United States this year is experiencing a fiscal deficit of up to 13% of GDP. Without timely correction, such large budget deficits will raise serious problems for international financial markets.

5. In emerging market countries, the vulnerability ten years ago was in sovereign debt. This time around, it is in corporate indebtedness, roll-over risk and default risk, in the background of insufficient or even non-existent framework for corporate restructuring and resolution. Therefore, the recovery values of these corporate debts will be very low and will hurt investors including banks in emerging market countries themselves. That is a challenge for all of us to face.

6. It is clear that the budgetary pressure in many developed countries may have an impact on ODA flow. Therefore, the international financial institutions and multilateral development banks should now turn their attention to helping the low-income countries.

Last, on behalf of the Institute of International Finance and my colleagues in the private sector, I would like to thank the Paris Club for organising this very interesting, useful, and dynamic conference.

Benoît Coeuré

Co-Chair of the G20 working Group 4 on the WB and other MDBs
Co-chairman of the Paris Club

Thank you everyone. I share the ideas expressed by Hung Tran, who did an excellent summary of the main lessons we learned from the conference.

I was struck by the factors of optimism that came through from the different speakers. This may seem a bit paradoxical. We are in a world crisis, the worst since 1929. We speak of world countries with populations that are suffering. Efforts to fight against poverty have diminished. Results have reduced because of the crisis. Yet, there are factors of optimism expressed by several speakers in the three round tables. It was said that the emerging countries and to a certain extent the poorest countries are more robust to deal with this crisis than they were to deal with the previous crises, thanks to the efforts that were deployed to improve the macroeconomic policies, thanks to the efforts in matters of governance, and thanks to what was done by the Paris Club for having cancelled their debts.

These are all factors of robustness to deal with the crisis. Hung Tran has shown us that the glass is half full. I would like to mention a few queries. There is a concern about how the international community is dealing with the situation with the least advanced countries. G-20 has done a considerable amount for these countries through the grant loans and development banks. This may not be enough. The fate of the least advanced countries should remain at the heart of concerns, in particular at the Pittsburgh summit. It is all very well to increase the sides of the balance sheets of development banks. However, it is necessary to find concessional funds. This is a budgetary issue for the parliaments and governments of the richest countries.

There were also technical questions that were opened around the use of the Debt Sustainability Framework. We would be grateful to the IMF and the World Bank if they could make concrete proposals. We also see that there is a deeper question for the world after the crisis, asked very clearly by Sri Mulyani Indrawati. We ask how the world can be organised in order to provide insurance to developing countries to assist them in overcoming the lack of confidence towards the financial institutions inherited from the 1990 crisis. Here, a tension has clearly appeared between the efforts deployed to strengthen the roles of the international institutions and a worry on the part of the developing countries of not being able to count on their own forces. The effort has to be made by the international community to create that confidence. This goes through the coordination of institutions and between the different funding entities. I hope that a collective answer will be brought to these questions. The September Pittsburgh Summit will be the opportunity to raise these questions again.

As Christine Lagarde said at the beginning of this conference, the Paris Club is an organisation of creditors above all, but it is also a place of exchange of views and of collective reflection like the one we have had today.

Thank you very much to all, to the participants for their presence and their contribution and to all those who came today to listen and ask questions. Thank you to the secretariat of the Paris Club for its very efficient organisation.