THE GLOBAL ECONOMIC CRISIS

DEVELOPING ECONOMIES AND THE ROLE OF MULTILATERAL DEVELOPMENT BANKS

ADDRESS

by

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TO THE

INTERNATIONAL LABOUR OFFICE (ILO)

GENEVA, SWITZERLAND

MARCH 22, 2010

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The Global Economic Crisis: Causes and Extent

As is well known, there are several features of the global economic crisis. First, the degeneration of a sub-prime mortgage market crisis concentrated in a few industrialized countries into a global financial crisis immersing banks and other financial institutions in the US, Europe, Japan and, to a lesser degree, developing countries in Asia, Latin America and the Caribbean. Second, the onset of the global economic recession in the third quarter of 2008, manifested most strongly in the US and the UK but also evident in all of industrialized Europe, Japan and China with spillover effect on economic growth in emerging economies and low income countries. Third, there was massive loss of personal wealth_and incomes in the US and Europe. Fourth, there was also substantial reduction of the value of equity, major income losses and onset of bankruptcy in the corporate sector of the same countries, affecting major sectors and industries. Fifth, the collapse of international commodity prices and slower growth in world trade as world economic growth contracted and the speculative boom in commodity prices collapsed. Sixth, foreign exchange market pressure on the US dollar and the pound sterling resulting in depreciation of bilateral exchange rates with the Euro. Seventh, extraordinary claims on the fiscal revenues of the most affected industrialized countries for finance of domestic stimulus programmes and rescue packages.

The economic recession was full blown in 2009. Real GDP growth was negative 3.3% for OECD countries as a group, negative 3.9% in the Euro area, negative 5.4% in Japan and negative 2.5% in the US. World trade decreased by 14.4%, non-energy commodity prices by 21.6% and oil prices by 36.3%. Interest rates on 6 month dollar securities fell from 3.2% in 2008 to 1.2% in 2009. The fall on Euro securities was even greater: from 4.8% to 1.5% over the same period.

Transmission to Developing Countries

The global economic crisis was transmitted to developing countries through four main channels: foreign trade, foreign direct investments, foreign financial capital flows and migrant remittances. Many Caribbean countries are acutely dependent on foreign trade with very high ratios of foreign trade to GDP, geographical concentration of trade on a few markets, and commodity concentration of exports. Demand for mineral exports of Latin America and Caribbean countries decreased and prices fell. This led to a contraction of output and in some cases to unemployment. In Jamaica, alumina output in value terms fell by 70% and bauxite production was at 60% of capacity in 2009. In Guyana and Suriname where bauxite and alumina are also important industries, production activities also slowed substantially. In Trinidad and Tobago, the collapse of international energy prices in the second half of 2008 and declining global demand led to unplanned output reductions.

For many Latin American and Caribbean countries, tourism services are a major export, especially in the Caribbean island economies where it is the principal export, contributing anywhere between 11%-30% of employment and 9%-27% of GDP in the tourism dependent economies. This industry has been greatly affected by the global crisis. According to the World Tourism Organisation, a 5% growth in international tourist arrivals in January to June 2008 was followed by a 1-2% decline in July to December of the same year and a 4% decrease in 2009. Most Caribbean islands experienced double-digit reductions in stayover visitors in 2009.

In respect of financial flows to developing countries, foreign direct investment fell from \$123 billion in 1st quarter 2008 to \$69 billion in 3rd quarter 2009. Syndicated bank lending was significantly lower in 2009 than in 2008, except in Latin America and the Caribbean. Nonetheless, a few Caribbean countries because of their already excessive public indebtedness and fiscal weakness began to lose standing in the international capital markets. Altogether, foreign capital became less accessible to developing countries.

Migrant remittances have become a substantial source of foreign exchange for many developing countries, sometimes outstripping commodity exports and services exports in their contribution to the balance of payments. Their general economic importance is reflected by their estimated share of GDP (19-23% in some Caribbean countries) and their role as income supplements to the economically disadvantaged members of society. Largely as a consequence of continuing job losses in host countries for migrants, notably the US, the Middle East and Europe, migrant remittances are projected by the World Bank to fall by 6.1% in 2009. Actual flows to Latin America and the Caribbean decreased from \$69.2 billion in 2008 to \$58.8 billion in 2009.

Through these channels, the global economic crisis has depressed economic growth in the developing countries. In Latin America and the Caribbean, real GDP which grew by 5.5% in 2007 and 3.9% in 2008, decreased by 2.6% in 2009. In Sub-Saharan Africa, real GDP had grown by 6.5% and 5.1% in 2007 and 2008 respectively, but declined by 1.8% in 2009. In Europe and Central Asia, positive growth rates of 7.1% in 2007 and 4.2% in 2008 were followed by negative growth of 6.2% in 2009. Elsewhere, economic growth rates while not becoming negative slowed down. Among the 18 Caribbean member countries of the Caribbean Development Bank (CDB), real GDP growth was negative in a range of 1% to 8% in 12 cases, and is expected to remain negative in 2010 in 5 cases.

With falling economic growth rates came job losses, rising unemployment and higher levels of poverty. In the Caribbean, unemployment rates certainly increased between 2008 and 2009, for example from 8% to 10% in Barbados, from 8.7% to 12.1% in the Bahamas. It is known that the incidence of poverty is quite high in Africa and Asia. In South Asia, there were one billion people living on less than $2 a day in 2005. The Asian Development Bank speaks of 900 million persons in its zone. In sub-Sahara Africa, there were as many as 555 million persons living on less than $2 a day in 2005. In Latin America and the Caribbean, there were 91 million persons below the poverty lines. In the Caribbean sub-region covered by CDB, the number of persons below national poverty lines seems to be 6.8 million persons, of which approximately 4 million are in Haiti. In situations of high levels of poverty, crisis induced unemployment and reductions in the flow of migrant remittances can entail major material and social hardship.

Counter Cyclical Response By Developing Countries

Like the governments of the industrialized countries, the governments of developing countries can seek to engage in a variety of counter cyclical economic policies, including fiscal expenditures on economic and social infrastructure with a view to raising aggregate demand and creating employment. They can provide direct subsidies and budgetary grants to enterprises to lower costs and augment net revenues, and do likewise to households as a means of social protection. They can provide tax reliefs and waivers on a temporary basis to stimulate economic activity. They can create special credit facilities, either of general applicability to enterprises or targeted to selected sectors or industries.

The problems that governments face in these kinds of endeavours are not merely those of appropriate design and exit strategy, but even more important the lack of fiscal capacity to implement them on a sufficient scale and for sufficiently long periods of time. Not only have fiscal revenues been weakened by the economic downturn but also their ability to incur commercial debt has been compromised by already high levels of indebtedness. Of necessity, they must turn to official sources of external capital, primarily the international financial institutions and multilateral development banks.

Prospects for Global Economic Recovery

The prospect for economic recovery in developing countries is contingent largely on economic recovery in the economies of their principal economic partners in the industrialized world. The World Bank has forecasted that global real GDP will grow at 2.7% in 2010 and 3.2% in 2011. It has noted however that significant uncertainty is attached to these forecasts, because they are dependent on the recovery of consumption and investment expenditures in response to monetary and fiscal stimulus. Given the depth and spread of the recession and its consequential substantial job losses, it is more likely that recovery will be more protracted than the forecasts envisage. For instance, the slow recovery of jobs in the US has necessitated the legislation of an $18 billion incentive programme for job creation in the US on 18March2010. There are also concerns about the effects of substantial overhang of public sector debt and household debt in the UK and other European countries.

The World Bank has also projected economic growth in developing countries. It has forecasted growth rates of 3.1% in 2010 and 3.6% in 2011 in Latin America and the Caribbean, and growth rates of 2% and 2.7% in Sub-Saharan Africa. Already, indications are that the forecasted increases will not be achieved in 2010. In the Caribbean, tourism demand has not recovered in 2010 and instead seems to be decreasing more severely than in 2009. More generally, one has to allow for the possibility of a delayed response by developing countries to a global upswing as trade markets and international capital markets change from recession mode to expansionary mode.

Financing Economic Recovery and Adjustment in Developing Countries

As noted earlier, developing countries have limited fiscal capacity for financing sustained economic stimulus programs. They have also struggled to obtain finance for medium term economic adjustment aimed at sustainable economic growth, maximizing productive employment opportunities, and ensuring a decent quality of life for all. Access to international financial resources is therefore critical. The World Bank estimates that $1.1 trillion is needed in 2010.

The G20 Summit on 2 April 2009 gave recognition to the critical importance of providing development and stabilization resources by agreeing to provide $850 billion of resources through the IMF and multilateral development banks to support growth in emerging and developing countries by helping to finance counter-cyclical spending, bank recapitalization, infrastructure, trade finance, balance of payments support, debt rollover and social safety nets.

Within this framework, the World Bank has initiated through its International Development Agency a Global Food Response Programme and a Rapid Social Response Fund to be used for social safety nets, infrastructure, education and health. It has also established a Global Trade Liquidity Programme, an Infrastructure Crisis Facility and a Microfinance Enhancement Facility within its International Finance Corporation.

The Inter-American Development Bank has created a $6 billion Liquidity Program for Growth Sustainability and within the Multilateral Investment Facility an Emergency Financing Facility for microfinance institutions.

Most Caribbean countries because they are middle income rather than low income countries are excluded from access to the IDA resources of the World Bank; some have also been graduated from access to its general resources. Nonetheless, they have been greatly affected by the global economic crisis because of structural dependence on the global economy, vulnerability to external economic shocks, and vulnerability to natural hazards. Their financial needs are no less significant than those elsewhere in emerging and developing economies and should be addressed by the multilateral development banks and IFIs.

Caribbean Development Bank

A sub-regional development bank like CDB has an important role to play in intermediating international funds from the global community for the benefit of its borrowing member countries. It is doing this by utilizing its Triple “A” capital market rating to raise commercial funds on favourable terms to lend regionally. It also obtains grant funds from regional and non-regional countries for financing of poverty reduction projects with particular attention to enhancement of human capabilities, labour force skills enhancement and sustainable employment and economic growth.

Since the onset of the global economic crisis, CDB has drawn heavily on its resources to provide policy based loans as a means of budgetary support to Caribbean governments. A key principle underlying these interventions is that plans for economic and social development and poverty reduction should not be derailed by what ones hopes is a short term economic crisis.

In addition, the Bank plans to provide, between 2010 and 2011, up to $260 million in capital investment loans and more than $50 million in loans to financial intermediaries to support small and medium-size enterprises and micro-enterprises in various industries and for loans to tertiary education. Community development and poverty reduction will be especially addressed through a Basic Needs Trust Fund with $78 million of grant resources over four years. Between October 2008 (the onset of the global crisis) and March 4, 2010, CDB has disbursed in excess of $260 million and approved much more for future disbursements.

The CDB estimates that its Borrowing Member Countries will have gross borrowing requirements in excess of $5.7 billion in the current decade. The CDB estimates that the direct call on its ordinary capital resources would be at least $3 billion, well in excess of what its current capitalization would permit. Accordingly, the Bank is engaged with shareholders in negotiations for a large increase in authorized capital which would make it possible to respond to about 75% of the projected demand.

Apart from its financial role, CDB seeks to lay a secure foundation for future employment and incomes by advocating and helping to put in place some fiscal and other financial economic policies and regulatory, public administration and justice administration frameworks conducive to private sector investment and development and to public trust and confidence in national governance systems.

For the Caribbean, economic integration is another essential plank in the development architecture. The CDB, in keeping with its Charter mandate, diligently pursues this objective, contributing actively to the establishment of critical institutions for economic integration and seeking to ensure balanced development among the members of the Caribbean Community.