Chapter VI

International Responses

International cooperation in response to the financial and economic crisis was spearheaded by the leaders of the G20 countries who, at their summits in London and Pittsburgh in 2009, pledged to undertake and continue for as long as necessary the stimulus and other extraordinary recovery measures that they had initiated.[35] The G20 leaders also pledged to deliver on all aid and other international development commitments and to resist protectionist tendencies. At the Pittsburgh Summit, they agreed to establish a policy coordination framework for balanced and sustainable growth of the global economy. Thus, those leaders committed themselves to avoiding the "beggar-thy-neighbour" policies that had hampered recovery from the Great Depression of the 1930s.

However, thus far, actual policy coordination has been superficial at best, and has lacked a more concrete framework with clear policy targets, sufficient consensus on the size and time horizon for continued stimulus measures and mechanisms to make concerted actions binding. This chapter examines some salient features of the G20 responses, particularly those aimed at supporting developing countries, and crisis lending by the International Monetary Fund.

Crisis response of the Group of Twenty

The crisis generated a strong initial response led by G20 leaders in terms of increased official financing for developing countries and those countries with economies in transition, as well as middle-income countries. Financial commitments of $1.1 trillion were announced at the G20 Summit held in London on 2 April 2009. This included allocation of IMF special drawing rights (SDRs) worth $250 billion, though nearly half (44 per cent) of this amount went to G7 countries under SDR quota entitlements. Only $80 billion (32 per cent) was for developing countries, with low-income countries only eligible for about a fifth of this (see table VI.1). Further, only a fairly modest share of the increased lending by the 16 international financial institutions has benefited low-income countries.

While it is important to increase the support to middle-income countries in line with their significance in the global economy and the large number of poor people who live in these countries, it is even more important to increase support

35 The leaders of the G20 countries met in London in April and in Pittsburgh in September 2009.

for low-income countries as they face significantly greater challenges. As table VI.1 shows, the G20 response fell short in this regard.

Table VI.1

G20 responses to the impacts of the crisis in developing countries

Category	Amount (Billions of United States dollars)	
IMF financing	500	No new commitment
Financing by multilateral development banks	100	No matching commitment
Allocation of special drawing rights	250	44 per cent to G7; only $80 billion to developing countries
Trade Finance	250	No matching commitment
Total	1,100	

Source: Islam and Chowdhury (2009).

Further, lending by the international financial institutions was dwarfed by the massive drop in private non-FDI flows (portfolio investment and other private investments). Therefore, the counter-cyclical role of those institutions, although valuable, was modest and insufficient. The quantum of official financing furnished to emerging and developing economies in 2009 amounted to only $50 billion, about 15 per cent of the net private portfolio and other private financial outflows (–$331 billion) (Ocampo and others, 2010, table 3). In aggregate, net official flows to developing countries remained negative in 2009, albeit at a lower level than in previous years, and are estimated to have gone deeper into negative territory in 2010, continuing the trend of the past decade (United Nations, 2011, table III.2).

Unfortunately, with the advent of some early signs of recovery, the solidarity of leaders and their commitment to sustaining stimulus measures began to weaken from mid-2010. Despite their commitments at Pittsburgh, leaders of the G20 countries disagreed over sustaining fiscal stimuli and mounting public indebtedness, at their Summit in Toronto, Canada, in June 2010. The uncoordinated retreats to fiscal austerity by most OECD Governments (except for the United States) and some further monetary easing (especially in the United States) resulted in greater global economic uncertainty. Although the G20

Summit in Seoul, held on 11 and 12 November 2010, emphasized the need to support development and global policy coherence, it delivered few specifics for coordinated progress. Any further weakening of the G20 commitment to international policy coordination will have serious implications for social development both in developed and developing countries as it will further set back prospects for the strong, sustained and balanced growth envisaged and needed to mitigate the negative social impacts of the crisis.

Responses of the International Monetary Fund

Although the International Monetary Fund failed to anticipate the crisis, its timing or its magnitude, and could not forewarn its membership, it acted quickly to propose recovery measures. Its response to the recent crisis involved some radical departures from its earlier orthodoxy that guided the lending and policy advice it had given in recent decades, especially during the Asian financial crisis in 1997-1998. Soon after the outbreak of the current crisis, the Fund recommended the implementation of fiscal stimulus measures, especially in the affected developed countries, contrary to its earlier recommendations of fiscal and monetary tightening in the face of financial or balance-of-payments crises. The Fund argued that direct spending by Governments would be more effective than tax cuts and monetary policy measures. It also argued that Governments should make sure that existing programmes were not cut for want of resources. In November 2008, the International Monetary Fund issued a statement suggesting that, to be effective, fiscal stimulus packages across systemically important countries should be globally coordinated and should amount to about 2 per cent of their collective GDP.

Immediately after the collapse of Lehman Brothers Holdings, Inc., in September 2008, a number of countries facing extreme balance-of-payments difficulties—including Georgia, Hungary, Iceland, Latvia, Pakistan and Ukraine—were forced to seek assistance from the Fund in the form of standby arrangements. Several poor countries, especially in Africa, made use of the Fund's Poverty Reduction and Growth Facility, and by 31 December 2008, another set of countries, including the Democratic Republic of the Congo, had joined them. However, the amounts involved were comparatively very small: at the end of December 2008, the *total* amount of credit outstanding was only SDR 17.5 billion under the Fund's General Resources Account and only SDR 4 billion under the Poverty Reduction and Growth Facility.

As mentioned previously, at the G20 Summit in London in April 2009, the Fund's resource base was effectively quadrupled from $250 billion to $1 trillion. The Fund, as a result, promised that concessional lending to low-income countries would be increased tenfold over pre-crisis levels by 2014. The Fund also announced some changes in both the nature of and the conditions associated with its lending instruments. As part of its new Poverty Reduction and Growth Trust, it announced four "new" lending windows to become effective in January 2010.[36]

By the end of May 2010, the Extended Credit Facility, which replaced the concessional Poverty Reduction and Growth Facility, had promised about SDR 2.6 billion to 25 countries (an average of about SDR 100 million per country). However, less than half that amount (only SDR 1.2 billion) was actually disbursed. In 2009, total disbursements under the Poverty Reduction and Growth Trust amounted to only SDR 1.6 billion, while in the first two quarters of 2010, the disbursement was only SDR 0.5 billion. Since repayments were about the same in this period, this meant that there was no increase in net disbursements under the newly created Poverty Reduction and Growth Trust (International Monetary Fund, 2010c). With the larger lending windows in the Fund's General Resources Account, SDR 20.5 billion was proffered in 2009 and SDR 10.4 billion in the first half of 2010. Just five countries—Hungary, Pakistan, Romania, Ukraine and Greece—accounted for nearly half the amount disbursed. This means that the other countries received miniscule amounts from the Fund, and these amounts are unlikely to have gone very far in compensating for the loss of export revenues and private capital flows, much less in easing the constraints on domestic investment, consumption and growth caused by the crisis.

Meanwhile, the newly created Flexible Credit Line facility served mainly to support countries with strong economic fundamentals in warding off potential market attacks. While the facility has been made available to three countries, namely Columbia, Mexico and Poland, no money has actually been disbursed. It could be the case that the stringent criteria for eligibility—in terms of "strong macroeconomic fundamentals" and "good existing policies"—mean that in practice, very few countries needing access to such flexible credit arrangements would qualify, while qualified countries used the Flexible Credit Line primarily for precautionary purposes (International Monetary Fund, 2010d; 2011a; 2011b). As a result, the new facility functioned mainly to help improve market sentiment towards countries rather than to provide actual resources.

Such lending is small compared with the resources available to the Fund. As figure VI.1 indicates, committed resources have amounted to only abouquarter of the total usable resources under the General Resources Account, which covers the Standby Arrangements, Extended Arrangements and Flexible Credit Line. Uncommitted usable resources increased from SDR 213 billion in 2009 to SDR 230 billion in 2010 (International Monetary Fund, 2010c). The countries concerned have actually only been provided with a third of the committed resources. Clearly, the Fund is not lacking in additional resources that could be offered to developing countries as well as others more strongly affected by

36 The Extended Credit Facility, Standby Credit Facility, Rapid Credit Facility and Flexible Credit Line.

the crisis.[37] The fact that such small amounts have actually been made available to developing countries suggests that such facilities have not served as a viable alternative to the reduced availability of market finance.

In addition, an allocation in the amount of SDR 161.2 billion was finally approved in August 2009 after having been held in suspension since 1995. This increased the SDR holdings of members, including their cumulative SDR allocations, by 74.1 per cent of their quotas. A special allocation of SDR 21.5 billion was implemented on 9 September 2009 for those countries that had joined the Fund after 1981 and had therefore never received any SDR allocation. A general allocation of SDRs is directed towards easing global liquidity constraints rather than rectifying macroeconomic imbalances across countries or easing the specific liquidity issues of deficit countries. Owing to the practice of making allocations by quota, the amounts received by small developing countries have been extremely small. Furthermore, since these allocations were made when there was continuing economic uncertainty, most deficit countries simply added these SDRs to their existing foreign exchange reserves. It does not appear that the exchange of SDRs for "hard" currency (possible under the Fund's rules) has been used by any country since the crisis.

As noted previously, the Fund explicitly declared changes in the design of the agreed policy packages for all these programmes, the purpose being to strengthen the Fund's focus on supporting poverty alleviation and economic growth; protect public spending, even as the economic downturn cut revenues; increase spending targeted towards the poor; and focus loan conditions to enhance the transparent management of public resources.[38]

The Fund's internal review, published in September 2009, was positive about the changes in the mode and conditions of lending and their impacts. However, several independent assessments have found little significant change in the basic conditionalities imposed on recipient countries, notwithstanding some changes in preserving certain social expenditures or safety nets.

For example, Weisbrot and others (2009) examined agreements between the Fund and 41 countries to assess the extent to which the Fund had supported pro-cyclical macroeconomic policies in borrowing countries during the recent global recession. Pro-cyclical fiscal policy in this context involved a programmed reduction in the fiscal deficit—or an increase in the fiscal surplus—during

37 In any case, since the International Monetary Fund can borrow from the markets to lend to countries, this situation never needs to be a constraint to non-concessional lending under the General Resources Account.

38 See "International Monetary Fund Factsheet: IMF Support for Low-Income Countries", 24 March 2010. Available from: http://www.imf.org/external/np/exr/facts/pdf/poor.pdf.

a recession or a significant economic slowdown.[39] In contrast, a programmed decrease in the fiscal surplus (or an increase in the fiscal deficit) in such conditions may be considered counter-cyclical.[40] With regard to monetary policy, an increase in policy interest rates during a recession or a significant economic slowdown may be regarded as pro-cyclical, with an interest rate cut being counter-cyclical. Some agreements did not target growth in money supply and were thus not counted as pro-cyclical nor counter-cyclical on this measure. Some explicitly indicated a tightening of monetary policy, and these agreements were counted as pro-cyclical monetary policy. For other agreements that did not specify the direction of monetary policy, if growth in money supply was significantly less than nominal GDP growth, then that was counted as tightening.

This study found that 31 of the 41 agreements contained pro-cyclical policies. In 15 cases, both fiscal and monetary policies were pro-cyclical in terms of adding to contractionary or recessionary forces already operating in the economy concerned. Contractionary fiscal responses were required in the case of 23 agreements; significant reductions in the public sector wage bill, either through nominal wage reductions or by letting go workers, were stipulated in 18 agreements. Monetary policy requirements were similar, with 19 agreements specifying contractionary measures; 12 agreements required increases in interest rates when private borrowers, especially small producers, were already facing credit crunches and could not service existing loans. Even when fiscal policy was not explicitly contractionary, the focus was on raising fiscal resources through privatization of State-held assets, even in poor market conditions, which implied that Governments would receive relatively little for such sales from private—often foreign—purchasers.[41]

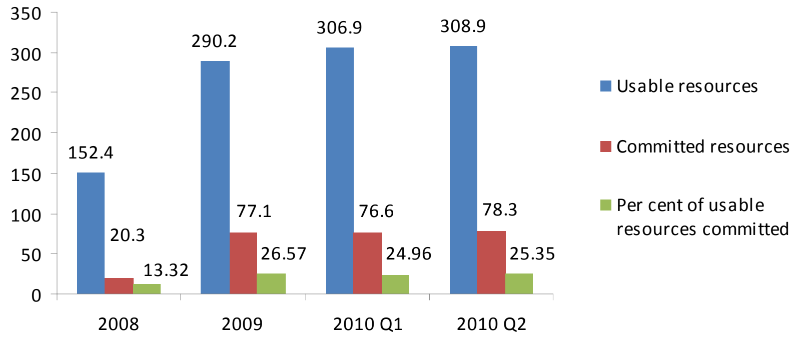
39 For example, in Hungary, the IMF agreement in 2008 called for reducing the fiscal deficit from -3.4 per cent of GDP in 2008 to -2.5 per cent of GDP in 2009, while GDP growth fell from 0.5 per cent in 2008 to a projected -6.7 per cent for 2009.

40 It should be borne in mind that periods of recession generally involve increases in fiscal deficits in any case because of the decline in government revenues and increase in government expenditures for social welfare programmes.

41 The Fund refuted the findings of the Center for Economic Policy Research; however, the Fund's own definition of "pro-cyclicality" and methodology for determining the programme's effects are deemed too narrow. In countries with "automatic stabilizers", following an economic slowdown, fiscal deficits normally grow as revenues decline and social spending increases. However, to regard the fiscal stance as pro- or counter-cyclical, one needs to examine whether there are discretionary changes in spending or tax measures. Between September 2008 and March 2009, the Fund negotiated Stand-By Arrangement loans with nine countries: Belarus, El Salvador, Georgia, Hungary, Iceland, Latvia, Pakistan, Serbia and Ukraine. An assessment by the Third World Network revealed that the Fund's fiscal and monetary policies remained as tight and restrictive now as in previous years. For example, its Stand-By Arrangement loan of $532 million for Serbia stated that "there is no scope now for counter-cyclical fiscal loosening. Anything less than a tight fiscal stance could also jeopardize the credibility of the program in the eyes of foreign investors and the Serbian public. Fiscal policy will in addition need to put

Figure VI.1

Usable and committed resources under the General Resources Account of the International Monetary Fund *(SDR billion)*



Source: International Monetary Fund (2010c).

Another study (Van Waeyenberge, Bargawi and McKinley, 2010), looking at 13 low-income countries that had received assistance from the International Monetary Fund since the crisis started, found that its basic macroeconomic policy orientation had hardly changed for those countries. Even economic liberalization and financial deregulation conditionalities or advice had not been revised.

In some cases, the Fund pointed to the need to protect and sometimes expand priority pro-poor social spending within a contractionary fiscal framework. However, developing countries were often forced to cut their fiscal budgets due to inadequate funding, including from the international financial institutions and the donor community. Many of these countries have predominantly poor populations as well as very inadequate infrastructure and public services, and can only provide minimal socio-economic rights for the majority of their people. Therefore, cutbacks in fiscal spending in such countries are likely to have direct implications for economic and social conditions, especially for the poor and vulnerable.

As for the structural conditions, the database indicates that, although most conditions were reflected in the Fund's core mandate—public financial

a tight constraint on wage growth in government sectors and public enterprises". (For more information, see http://www.twnside.org.sg/title2/par/IMF.Crisis.Loans-Overview.TWN.March.2009.doc.)

Box VI.1
Conditionalities of the International Monetary Fund

Using the Monitoring of Fund Arrangements database, which contains details on conditionality in International Monetary Fund-supported arrangements and tracks the performance of countries, the figures below were constructed to show the Fund's structural conditionalities per programme during the recent crisis.

For the Fund's Stand-By Arrangement, the average number of structural conditions per country during the period 2008-2009 was 12; on average the most frequent conditions were as follows: Structural Benchmarks[a] (7), Prior Actions[b] (3) and Performance Criteria[c] (1). For its Poverty Reduction and Growth Facility programme, the average number of structural conditions per country during the period 2008-2009 was 15; on average most conditions were as follows: Structural Benchmarks (9), Performance Criteria (3) and Prior Actions (2). For all Fund programmes during the period 2008-2009, the average number of structural conditions totalled 13, compared with the 17 described in the Fund's Independent Evaluation Office report for the period 1995-2004, which suggests some reduction in conditionalities unless they had been bunched.

For the Poverty Reduction and Growth Facility arrangements, the average number of conditions remained constant at 15, while the number of conditions under the Stand-By Arrangement declined from 19 to 12.

[a] These are to be applied to measures that may not be objectively monitored or where non-implementation would not, by itself, warrant interruption of IMF financing. They are intended to serve as clear markers in the assessment of progress on structural reform.

[b] These are measures that a country is expected to adopt before the approval of an arrangement or completion of a review. They are to be used when immediate enactment of the associated policy is seen as critical for the success of the programme, or when there are doubts that the measure would be implemented later if specified as a performance criterion.

[c] These are specific conditions that have to be met during a programme in order for the agreed amount of credit to be disbursed.

Source: Ocampo and others (2010)

management and financial sector soundness—the Fund continued to promote conditions in areas beyond that mandate, albeit less so if compared with the period before 2007. These non-core areas include state-owned enterprise reform, social policies, civil service reform or regulatory reform, particularly for subscribers to Poverty Reduction and Growth Facility agreements (Independent Evaluation Office of the International Monetary Fund, 2011, see tables A.1 and A.2 in the Appendix to the evaluation report for some examples of structural conditions for the different countries that sought help from the Fund between 2008 and 2009. Significant concerns remain about the nature of some macroeconomic policies promoted by the Fund, which many see as pro-cyclical.

Policy responses to the food crisis

In response to the severity of the global crisis in food prices, the international community reacted quickly and tried to stabilize food prices in low-income food-deficit countries and to reduce the impact of this crisis on the world's poor and vulnerable households. In large measure, these responses were driven by the desire to protect poor and vulnerable households from falling into extreme poverty and hunger, as well as to avoid political instability in some poor countries that had seen widespread discontent, including food riots.

The United Nations, international financial institutions, regional development banks and other international philanthropic organizations rapidly mobilized resources and deployed a series of measures to help protect vulnerable populations. In April 2008, the Secretary-General of the United Nations set up the High-Level Task Force on the Global Food Security Crisis for the purpose of developing a long-term response to the crisis. The United Nations system also increased assistance to food-deficit countries. The World Bank set up its Global Food Crisis Response Programme in May 2008 to provide countries strongly affected by the crisis with immediate assistance in reducing the threat posed by high food prices, and more recently, the Global Agriculture and Food Security Programme, a multilateral financing mechanism which enables the immediate targeting and delivery of additional funding to public and private entities to support national and regional strategic plans for agriculture and food security in poor countries. Financial contributions to the Global Agriculture and Food Security Programme to date have been provided or pledged by four G20 member countries, namely Canada, Spain, the Republic of Korea and the United States, as well as the Bill and Melinda Gates Foundation (World Bank, 2010e).

The G20 countries have also supported initiatives designed to increase agricultural productivity. In September 2009, in response to a G20 request, the World Bank took steps to establish a special multilateral trust fund to boost agricultural productivity and food security in low-income countries. The G8 Summit in Italy in 2009 launched the l'Aquila Food Security Initiative and pledged $20 billion over 3 years in support of comprehensive, country-led and coordinated responses to food insecurity. However, the fulfilment of these commitments has been slow and there remains considerable doubt whether these commitments will be met at all.

Concluding remarks: a balance between stimulus and austerity

A closer look reveals that the pledges made by the G8 and G20 countries to help poor countries cope with the Great Recession largely involve repackaging previous aid commitments. There is little in the way of providing new funds so that poor countries could protect their progress in social development. In 2009, the President of the World Bank Group called for developed countries to commit

0.7 per cent of their stimulus packages to the newly created "vulnerability fund" to foster recovery and strengthen social protection in those developing countries with inadequate fiscal means to do so on their own resources. Available evidence suggests that new commitments in the area of education, for example, have fallen far short of the amounts requested (United Nations Educational, Scientific and Cultural Organization, 2010).

More worrysome, the austerity programmes that many donor countries are now implementing are likely to result in cuts in their aid budgets at a time when low-income countries have the greatest need for such aid support. In particular, low-income countries with limited fiscal space need additional ODA in order to finance the expansion of social services and programmes to meet the Millennium Development Goal targets, as well as to pursue counter-cyclical and broader development policies. These increased needs contrast with the significant shortfalls in aid delivery against the long-standing commitments made by donor countries. Apart from delivering on existing aid commitments, donor countries should "delink" aid flows from their own business cycles in order to prevent delivery shortfalls during downturns, when the need for development aid is most urgent (United Nations, 2010e).

In response to the call for an internationally coordinated and funded response to the crisis, the international financial institutions have started to rethink their approach and acknowledged the importance of stimulus spending, including maintaining and increasing social spending to address the crisis. This represented a departure from the previous approach of these institutions. However, there is significant evidence of a disconnect between policy pronouncements and actions as actual policies and operations have not fully reflected the new thinking.

If there is to be any hope of success in meeting the Millennium Development Goal targets by 2015, rich countries will need to support social and economic recovery in the poorest countries by fulfilling their aid commitments and expanding debt forgiveness and workouts.

Finally, Governments in developed countries should seriously evaluate the social impacts of their austerity measures. They are not only directly reducing social spending and contributing to joblessness in their own countries, but are also placing national and global recovery at risk, making it even more challenging for poor countries to protect the gains they have made towards achieving the Millennium Development Goal targets and accelerating social progress.