

The Global financial crisis: Impact, role and response of The Economic Commission for Africa (ECA)

Introduction

The world economy is facing the worst financial crisis since the great depression. The crisis is taking place at a time when African countries are slowly emerging from the effects of the food and energy crises and threatens to reverse the gains made by the region in recent years. Furthermore, it has changed the international environment within which African countries conduct and implement policies and there is general consensus that bold, swift and concerted actions are needed to reduce the potential negative effects of the crisis on poor countries.

Consequences for Africa

The immediate effects of the crisis on African economies have been a tightening of credit, weakening currencies and declining stock markets, especially for some of the major stock exchanges in Africa. Moreover, most African countries are likely to suffer from second round effects, resulting from a decline in global economic activity which would lead to a decline in African exports, trade credits, investments, remittances and tourism receipts. In addition, pressures to recapitalize financial institutions and support other ailing industries may cause donor countries to reduce aid to developing countries, with serious consequences for the African countries that rely on official development assistance to meet their pressing challenges. Preliminary evidence indicates that the crisis has led to a reduction in the growth forecasts for the continent for 2009 by 1.5 percentage points.

Response and Role of ECA

Most of the discussions on policy responses to the current global financial crisis has thus far focused on national and international actions. The regional and sub-regional dimensions are completely missing. Yet they are of immense importance, especially in light of the limited capacity of many African countries. Against this background, the ECA, the African Union Commission (AUC) and the African Development Bank (AfDB) have taken several actions to assist African countries in dealing with the effects of the crisis. For example, ECA in collaboration with the AUC and the AfDB organized a High-Level Forum on the Financial Crisis for Ministers of Finance and Planning and Governors of Central Banks in Tunis on 12 November 2008. The Communiqué issued at the end of the meeting outlines measures to be taken at the national, regional, and international levels to mitigate the effect of the crisis on African economies. A follow up meeting involving development partners was also organized during the just concluded Doha Review Conference on Financing for Development.

The ECA has also provided research support to African countries on the Financial Crisis. For example, it prepared papers on the Impact of the Financial Crisis on Africa and on the Reform of the International Financial Architecture which formed the basis for discussions by African Ministers and Central Bank Governors at their meeting in Tunis. ECA will strengthen its advisory role by helping African countries harness potential natural resource revenue, and prudently using such resources for sustainable growth and development. In addition, we will continue to provide technical assistance to enable African countries build capacity for policy design and implementation, including deepening economic reforms.

ECA will also help African countries reduce their vulnerability to external shocks by providing support in the development of productive capacities. This will enable them to diversify their exports and production, thus increasing their resilience to external shocks. The Tunis meeting also mandated ECA and the African Union Commission to put the issue of fiscal policy and domestic resource mobilization on the agenda of their next Joint Conference of Ministers of Finance. ECA also serves on the Secretariat of a Committee of Ten African Ministers of Finance and Governors of Central Bank established at the Tunis Meeting to articulate Africa's positions on the reform of the international financial architecture.

Impact on the Work of ECA

Since the onset of the crisis Member States have increased their demand for technical assistance and support to enable them cope with the potential effects of the crisis. These requests cover three key clusters: research support; advisory services and advocacy; and facilitating African consensus on policy responses to the crisis. One of the areas where our Member States have a keen interest is in the reform of the international financial architecture. In recognition of this, ECA has made appropriate provisions in our current as well as the 2010-2011 biennial work programme to enable us provide technical assistance to African countries in this area.

ECA has conceptualized a Regional Forum on Financing for Development to enable African countries address the challenges that they likely to face from future declines in development finance as a result of the effects of the financial crisis. Finally, a meeting on Financing for Development and Fiscal Policy is planned in February 2009 to enable African countries examine alternative sources of development finance and the role of fiscal policy in harnessing resources from these sources.

The ECE's Regional Perspective on the Global Financial Crisis and Its Impact on the UNECE Program of Work

Regional Impact: The global financial crisis is having significant impacts on all the sub-regions covered by the Economic Commission for Europe (whose membership comprises 56 countries), but the effects vary considerably due to the different economic circumstances in the various regions as do the needed policy responses. North America and Western Europe are facing severe downturns with likely negative growth for all of 2009, while growth in the new members States of the EU (NMSs), South-east Europe and the CIS is expected to slow down considerably from their recently robust rates to only about two per cent.

- Although the initial shock was much more significant in the United States (compared to western Europe), the policy response in the former in terms of aggressive monetary and fiscal policy has been much greater and as a result the likely downturn is likely to be similar in the two areas. The European response has been limited by inadequate regional co-ordination and built in institutional limitations in effectively being able to use macroeconomic policy. More generally, economic policy in North America and Western Europe must deal with addressing the meltdown in their financial sectors by providing governmental financial support, attempt to provide stimulus to minimize the recession mostly through increased fiscal expenditures, and begin to redesign the structure and regulatory apparatus of their financial markets to avoid a repeat of the current crisis.
- The NMSs and South-east Europe have developed based upon an economic model dependent on capital inflows from abroad; with the freezing-up of global credit markets their ability to maintain this growth strategy is no longer viable and they find themselves in a period of substantial macroeconomic vulnerability. A number of the European CIS, although not net external borrows, have had a growth strategy dependent on large private sector borrowing from abroad and essentially find themselves in a similar situation. The adjustments that all of these economies will need to make in terms of their exchange rates, credit growth, asset prices, and fiscal spending will be significant and could potentially precipitate domestic financial crises in a significant number these economies. Severe recessions in their major export markets will further weaken their economies. Already six of these economics have had to turn to the International Monetary Fund for support and that number is likely to increase further as the crisis develops.
- The central Asian CIS will primarily be impacted by the reduction in their exports, the decline in commodity prices and lower remittances from reduced opportunities from working abroad.

Regional Response: Despite globalization, the strongest trade, financial and remittance links for the ECE economies remain with those countries nearby. For this reason a regional approach is an important component of any policy package for addressing this crisis. For example, a fiscal expansion in a European economy will rapidly leak out through trade and financial linkages and will be of little significance

for the country that initiated the policy. Thus, whether it is fiscal and monetary expansion or capital market regulation, the actions for addressing this crisis must be regionally coordinated if they are to be effective. The failure to fully appreciate this is already apparent in Europe with the uncoordinated response to deposit insurance in European banks last month and remaining unresolved issues of cross-border financial responsibility and supervision.

The fact that there are extensive cross-border banking relationships in Europe, especially between Western European parents and newer Eastern European subsidiaries is of particular interests for the stability of the region. It remains unclear whether these banking relationships will prove stabilizing in that they will provide Eastern European banks access to funds that they would be unable to obtain on currently seized-up global capital markets, or whether they will instead prove to be a channel of contagion by which the collapse of banking institutions in Western Europe spreads eastward. How this plays out will significantly affect other developing countries' future policies regarding financial liberalization and their perceived need for additional regional or global oversight.

The UNECE Response to the Current Economic Crisis

The UNECE has a large number of committees, working parties, seminars and work shops that routinely address current developments relating to achieving the long-run objectives of their activities. These meetings have generally attempted to include discussions regarding the implications of the current economic situation for their programs of work. For example, the UNECE program on innovative finance attempts to determine best practices in helping new firms obtain financial backing. With the collapse of credit markets, the discussions in that group have explored ways to obtain alternatives sources of finance. A similar change in emphasis is apparent for a program promoting energy efficiency with has traditionally leveraged limited public resources in order to obtain additional private resources. Likewise, a workshop describing how to establish and administer Public Private Partnerships is attempting to address the opportunities and challenges from tighter private capital markets but perhaps increasing fiscal expenditures. Since both public and private funding for a number of activities supported by the UNECE (i.e., regional infrastructure projects) have been withdrawn, the work plans of these groups have had to explore alternative timing horizons and funding sources (i.e., World Bank, EBRD, etc.). Thus although often no new meetings not previously planned are held and no new mandates are developed, these programs, nevertheless, very much consider the economic context of their activities and have adjusted their discussions, work programs and policy advice as appropriate.

The UNECE will have a day-long segment of its upcoming Biennial Commission Session (at the end of March 2009) discussing how the economic crisis (and other recent developments) will impact its core economic mandates. Suggestions may come out of that meeting regarding how future UNECE activities might need to be adjusted in order to deal with the new challenges. At a general level, the expected outcomes include:

- 1) more emphasis on monitoring economic developments and how they are impacting UNECE activities ;

- 2) more focus on the need for transparency regarding regulations, norms, and standards in areas covered by UNECE programs; and
- 3) a renewed political commitment to international co-operation and integration in recognition that the economic crisis requires regional and global solutions.

The Real Estate Market Advisory Group (REM) of the UNECE organized with the UN Secretariat a seminar (The Real Estate and Financial Crisis: Causes, Effects and Impacts) with a panel of experts in December 2008 addressing the real estate policies that need to be implemented at the national, regional and global level to address the current financial crisis and the initiatives that are needed to ensure longer-term financial stability in the industry. The group has shifted its focus towards addressing financial stability in addition to its usual emphasis on environmental sustainability and social responsiveness. A follow-up meeting by the group will be held in March 2009 in Rome to discuss a set of “Guidelines for the Development of the Real Estate Market for Social and Economic Benefits”.

The UNECE is in the process of strengthening its MDG related activities in response to the fact that the economic crisis will undoubtedly reduce the ability of its developing member States to achieve the targets on schedule. The UNECE statistical program is increasing resources devoted towards producing and measuring national indicators of MDG targets. A new economic analysis position has been created to analyze MDG trends and policy initiatives with the intention of being better able to establish best practices for achieving the targets.

The current international financial crisis and its impacts on Latin America and the Caribbean ¹

Brief note prepared by ECLAC

6 January, 2009

The origins

The ultimate causes of the current international financial and economic crisis are structural in nature. First, the institutions and practices of the so-called new financial architecture which is comprised by a global system of giant investment banks, hedge funds and special investment vehicles is poorly regulated or totally lacking in regulation. Second, the crisis unfolds at a time of severe global imbalances (the imbalance between labour and capital mobility; the United States trade deficit and the predominance of financial capital over productive capital). Thus the bubble in the subprime mortgage market and the subsequent debt deflation, the long period of abundant liquidity and low interest rates prior to the crisis led to a global quest for higher returns and a general underpricing of risk by investors; and the high levels of indebtedness of the private sector, particularly in United States households, are rather a symptom and a reflection of financial and non-financial structural causes which lay at the heart of contemporary economies.

In the United States, the crisis was shaped by perverse incentives and excessive risk-taking in the “shadow financial system”, including among poorly regulated financial intermediaries, as well as by complex and opaque securitization structures and instruments (credit default swaps and collateralized debt obligations) which were not priced correctly. The high leverage and widespread systemic risk thus generated have spread beyond United States borders, resulting in strains on a scale and scope not witnessed in the past three quarters of a century. Two points are worth noting. One is that systemic risk built up progressively in the system. The second is that this build-up went unnoticed until it was too late. Financial innovation in a period of economic boom appears to have hidden it from view.

Following the turmoil in the subprime mortgage market and the loss of value of a massive amount of derivative instruments that were built on them, global economic conditions have deteriorated sharply since mid-September 2008. The outlook and the external environment for Latin America and the Caribbean have also worsened significantly. International economic conditions started to deteriorate in mid-2007, when the increase in the unemployment rate in the United States triggered the collapse of the subprime mortgage market. The failures in this market swiftly started to impact on the balance sheets of established financial institutions which owned and sold derivative instruments with subprime mortgages as underlying assets. At the same time, the global economy was being hit by a sharp increase in food and energy prices, which led some

¹ Brief Note prepared by ECLAC as an input for the CEB/HLCP. Please forward any comments to René Hernández (rene.hernandez@cepal.org) with copy to Filipa Correia (filipa.correia@cepal.org).

central bankers to increase interest rates in order to curb inflationary pressures, while others kept the tight monetary conditions adopted during the boom phase.

ECLAC presciently affirmed that the high price volatility of raw materials, particularly food and hydrocarbons, was a global phenomenon attributable to a combination of factors. Some of these factors are structural in nature: population growth and rising incomes, which are in turn associated with growing demand for food; rapid industrialization in Asia, which has fuelled the demand for raw materials and energy; and widespread subsidization of biofuel production in Europe and the United States, which is adding to the upward pressure on prices in agricultural markets. Other factors are of a more speculative nature, such as the excess liquidity and the influence of hedge funds, which are increasingly oriented towards commodity markets. Whereas the recent drop in some raw material prices reflects the important role played by speculative movements in the volatility of those markets, the relative weights of structural and speculative factors in price movements are not yet clearly defined.

Three inter-related global shocks which are hitting the world economy are now becoming mutually reinforcing: the financial crisis, the slowdown in growth, and changes in international relative prices. The global crisis is already hitting the Latin American and Caribbean region and uncertainty is rife. The bankruptcy of Lehman Brothers marked the beginning of a period of unravelling in world financial markets, with trust among financial institutions evaporating. After the collapse of that entity, global short-term money markets froze, with short-term business operations becoming extremely expensive. The commercial paper market came to a halt, and no one was willing to lend. Since then, credit spreads have widened sharply, stock markets have plunged and economies everywhere are stumbling. Financial contagion has spread across the broader economy and the global economy. The response to the crisis has focused on unlocking credit and preventing further damage to the global economy.

The G20 countries agreed to a set of common principles designed to reform financial markets; reforming the global regulatory system must wait, however, until a clearer picture emerges of what lessons can be learned from the current crisis or how much regulation should be transnational. The November 2008 summit was a first step on the road to define the right framework for the international financial architecture of the twenty-first century. It was also symbolic, and suggests that in the future, the G20 may replace the G8 as the steering committee for the global economy.

This time around, emerging markets were not the instigators of the crisis, but their aggregate demand is now more vulnerable to a global downturn because of their dependency on external demand and foreign investment. Financial institutions and hedge funds in developed economies rapidly pulled out massive amounts of money from emerging markets, creating problems for local markets and banks. International lines of credit, the lifeblood of international transactions, were also frozen, affecting trade and leading to reduced export earnings.

Governments in emerging markets are also acting decisively, cutting rates and injecting liquidity into their banking systems. Some countries have room for an additional fiscal stimulus, but this is not the case for the poorest countries, which do not have the fiscal space to implement counter-cyclical policy. Foreign aid needs to have an essential role. Developed countries would need to act upon the commitments they have already made to increase foreign aid to developing countries.

Is the current international financial crisis an accident resulting from a fundamentally well-designed global financial system or is it a fundamental and structural break from the current system, which requires a new international financial order? In either of these situations, the worsening economic and financial conditions place stronger emphasis on the design of counter-cyclical policies during downturns.

ECLAC has always advocated the preponderance of a diversified production structure, both in terms of production composition and export markets, in achieving sustained robust economic growth. Independently of other elements, such a production structure underscores the need to create the necessary foundations for an increase in investment in physical and human capital and in total factor productivity. Without them, a successful reintegration of the region in the world economy, coupled with the consolidation of a sustainable growth path, will not be possible.

This discussion ultimately leads to the conclusion that the region needs to formulate a new development agenda, one that leaves the so-called Washington Consensus behind and that allows the removal of major long-standing obstacles to economic growth. The current challenge is enormous and will require more than minor adjustments in the existing foundations of the region's linkages with the world economy.

The transmission channels

The global economic and financial crisis is expected to impact the economies of Latin America and the Caribbean through five main channels: i) financial contagion and external borrowing; ii) foreign direct investment; iii) external demand; iv) workers' remittances; and v) changes in relative prices (particularly commodity prices). The effects of the crisis will ripple through to both the macroeconomic and the microeconomic levels. From a social perspective, the global economic and financial crisis will be felt more sharply by the most vulnerable social groups. Poverty is expected to increase, especially because of higher food and energy prices and deteriorating conditions in the labour market. Employment will be the adjustment variable. The final result will be depend on the specific economic, social and institutional framework of each country of the region.

After the collapse of Lehman Brothers, the financial crisis had an increasing impact on the financial markets of Latin America and the Caribbean. In the final four months of 2008, the region experienced a slowdown in portfolio investment inflows, which afterwards started to decline. Furthermore, vast falls in regional stock markets were registered and currencies depreciated drastically, partly as a result of previous speculative

positions based on expectations of appreciation in Latin American currencies. However, companies with debt in foreign currency have seen their balances negatively impacted by the devaluations of several of the region's currencies. Unlike the situation in previous crises, the private sector seems to be the most exposed to exchange-rate volatility in many countries. Additionally, the cost of international borrowing soared, especially for firms, but also for sovereign debtors. The increase in sovereign risk premiums in the region has been nevertheless smaller than in previous crises, allowing for significant differences across countries.

Although the region's financial activity has not been exposed to "toxic" assets, the problems in the international inter-bank market and the impact of the tightening of external credit on local credit markets transferred part of the turmoil in the financial markets of developed countries to the region. However, the dimension of this impact is still not fully known, as current available information is insufficient to establish those results. Of particular concern are the credit access conditions for a series of large regional enterprises from several countries that usually find financing on international markets. Given the credit crunch and the higher price of credit in global financial markets, meeting borrowing requirements is expected to become more difficult. .

The reduced availability of external financing will force the larger private enterprises to turn to domestic markets, which are likely to suffer from liquidity squeezes. This, along with increased uncertainty, will probably make it more difficult for small and medium-sized enterprises to access financial resources. Inter-company borrowing along the production chain has also decreased sharply in the region, bringing to a halt established practices and investment projects, seriously hurting the financial position of an increasing number of firms.

The tightening of international financial conditions will also have an adverse effect on inflows of foreign direct investment (FDI), which were an important source of funding for some countries in recent years. FDI inflows in Caribbean countries, mostly related to tourism, accounted in 2008 for 15% to 25% of GDP. In the Dominican Republic, Costa Rica and Panama these flows accounted for 6.5% to 8% of GDP, and in Chile and Peru they were around 5% of GDP. Total FDI inflows into the region were slightly below the amount registered in 2007, resulting from an estimated increase of 7% in resource-rich countries, essentially in South America, and an estimated decrease of 25% in economies more dependent on exports, particularly manufactures and tourism, such as Mexico, Central America and the countries of the Caribbean. As the world economic growth loses its impetus, so will FDI inflows. The slowdown in developed countries decreases the need for efficiency-seeking and resource-seeking FDI in the region, whereas the slowdown in the economies of the region leads to cutbacks in the incentives for market-seeking FDI. Furthermore, the liquidity crisis limits the ability of firms to finance merger and acquisition operations, the most important form of FDI in Latin America and the Caribbean. In sum, FDI inflows are expected to decline in 2009.

The recession in developed economies and the significant slowdown in emerging countries will reduce demand for exports from Latin America and the Caribbean. The

position of the United States as an importer from Latin America and the Caribbean has varied considerably from country to country. Non-oil imports from Mexico began to slow in mid-2007 and continued to fall to the point where they registered a year-on-year contraction of 2.4% in the third quarter of 2008. Imports from the Central American countries have, on the other hand, behaved in much the same way as imports from other sources worldwide. This is because, although there is evidence of a slowdown and even of a contraction in Central American manufactures destined for the United States market, this decline has been offset by the higher prices obtained for commodity exports. United States imports from the Andean countries and MERCOSUR, consisting mostly of commodities, rose in tandem with commodity prices from mid-2007 until the third quarter of 2008, when they began to level off. China's imports from Latin America and the Caribbean, predominantly from the Andean countries and MERCOSUR, followed a similar pattern. This Asian country is also facing a decreasing demand from the developed markets for its manufactured products, which will impact on its economic impetus and, therefore, on its demand for commodities exported by the region.

The decrease in merchandise exports can be expected to have a greater impact on growth in the more open economies, in those that trade more with developed countries and, in particular, in those that sell a larger proportion of manufactured goods to developed markets, as it will be more difficult to find alternative markets for such goods at short notice. On the other hand, in some of the region's countries part of the negative impact on growth will be the result of lower demand for services, particularly tourism, for which demand is highly income-elastic. Caribbean countries and some Central American economies may be among the most severely affected by the downturn in this area.

The weaker job market in developed economies will have an adverse effect on the remittances that emigrant workers send back to their families in their home country. Remittances have been an extremely important source of external revenues in Latin America and the Caribbean, where they have helped to improve the well-being of low-income families. In some countries in Central America and the Caribbean – in decreasing order, Haiti, Honduras, Jamaica, El Salvador, Nicaragua and Guatemala – workers' remittances represent between 15% and 40% of GDP. In Belize, Bolivia, the Dominican Republic, Ecuador and Grenada these inflows represent between 5% and 10% of GDP. Therefore, any reduction in remittances will have a negative impact on the situation of low-income families in these countries. This is an important factor in terms of the impact of the global economic and financial crisis on employment and poverty in the region.

Falling commodity prices in the wake of slower world growth will result in the deterioration of terms of trade for the region as a whole, although with diverse effects in the different countries. The rate of increase in commodity prices rose steadily between mid-2007 and mid-2008. Although there was an across-the-board surge in commodity prices, the increase was particularly striking in the case of oil, certain metals such as copper, and foods such as soybeans, maize and wheat. The index for most of the region's exports peaked between June and August 2008. From then onwards, sharp declines ushered in the new recessionary and deflationary phase of the international crisis. Oil prices at the end of November 2008 were similar to those recorded in late 2004, while

metal prices resembled those observed at the end of 2005. Food prices, which had shown a smaller increase previously, fell less dramatically and levels in November 2008 were similar to those of mid-2007.

For many Latin American and Caribbean countries, commodities make up a considerable proportion of the export basket and, in some of these countries; they are a significant source of public revenue. Thus, decreasing or volatile commodity prices are expected to cause one of the recent engines of regional growth to come to a standstill. For the region as a whole, the terms of trade will have improved by 0.8% in 2008 and are forecast to worsen by 7.8% in 2009. For Chile and Peru, both metal exporters, the terms of trade are estimated to have deteriorated by around 8% in 2008 and 30% in 2009. For fuel-exporting countries, the terms of trade are estimated to have improved by 13% in 2008, before falling by almost 20% in 2009. As for MERCOSUR, where food comprises a major part of total exports, the rise in 2008 will be almost completely offset by the decline projected for 2009. In Mexico, the terms of trade are expected to have improved very slightly in 2008 and are expected to drop by over 2% in 2009. In contrast, as Central America and the Caribbean are net importers of commodities, the fall in oil, metal and cereal prices alleviates and partially offsets the consequences of the world economic slowdown and the above-mentioned fall in remittances.

The employment and poverty conditions in the region will be affected through all the above-mentioned transmission channels, whose relative importance will vary according to the production structure of the different countries. In the short-term, unemployment is expected to rise in numerous countries and real wages will come to a stand-still. In the medium term, difficulties in finding employment could lead to a fall in the participation rate, resulting from a decrease in the number of people that actively look for a job. At the same time, the slowdown of the Latin American and Caribbean economies will induce a decrease in labour demand from larger firms, which in turn will stimulate an increase in occupancy in low-productivity sectors, particularly when there is no unemployment insurance in place. The informality rate is close to 52% in the region, in spite of recent advances. Informal workers usually perform poor-quality jobs, associated with instability, low pay and lack of social security. Furthermore, given that small and medium-sized enterprises are traditionally the ones that create more jobs, the impact in employment will depend to a great extent on these companies' resilience in the face of the present adverse conditions.

The increase of employment in the informal sector will cause an increase in the proportion of workers that are poor or very poor, who do not earn sufficient income to be able to improve the living conditions of their families. In 2006, 33.2% of the informal workers were poor, compared with 15.9% among formal workers. There is a strong link between informality and poverty and extreme poverty, so there is a strong risk of rising poverty and extreme poverty if the current global crisis damages employment conditions and in particular increases informality. Furthermore, to the extent that lower income households lose other sources of income that they may have (such as remittances), poverty and extreme poverty are likely to increase. ECLAC forecasts the magnitude of these increases to be moderate. Nevertheless, 2008 may have already marked the end of a

5-year period of decline in the incidence of poverty and extreme poverty in the region. The latter decreased from 19.4 to 12.6% between 2002 and 2007 and stood at 12.9% in 2008, according to ECLAC estimates.

The policies adopted in response to the crisis

The Latin American and Caribbean countries have adopted a variety of policy measures in response to the financial crisis. Although the macroeconomic fundamentals are significantly stronger than in the past, the region will not be immune to the impact of instability in world financial markets and to the anticipated recession in the developed economies.

The range of measures implemented is quite diverse as the effects differ from country to country and the instruments needed also vary owing to differences in the resources available to the countries and in their ability to implement such initiatives. That availability generally depends on the fiscal space available for financing the measures, when their implementation entails the use of public funds or when they involve foreign-currency transactions, and it also depends on the availability of external assets or the access to foreign-currency credit. In the current circumstances, the latter is limited to dealing with international financial institutions. It is worth noting that Keynesian-type fiscal stimulus (increasing government spending in infrastructure projects among others) can be a positive solution, but policymakers must ensure that the stimulus package is implemented in a timely manner, ensuring enough credibility to avoid concerns about debt sustainability.

Beyond these considerations, taking into account the impact that these measures may have on the rest of the economy, a full analysis of the countries' capabilities should encompass other elements such as the degree of monetization, the depth of the financial market and the balance-of-payments current account balance. It should be remembered that a demand-led strategy based on increased public spending, aside from its fiscal impact, may widen the external deficit beyond a country's capacity to finance it. In this case, the availability of foreign-currency resources will be an issue even if there is plenty of fiscal room for manoeuvre.

In the short term, monetary and financial policies normally produce a swift reaction in the economy and their central objective is to avoid contagion from external financial instability. Examples of these measures include the reduction of reserve requirements, provision of credit lines to domestic banks, intervention of troubled financial institutions, repurchase agreements of government bonds and shift from long-term to short-term bonds. Actions to grant liquidity can be designed for either domestic or foreign currency. They are often used as short-term instruments to avoid further confidence losses, provide liquidity and enable local credit markets to function normally, supply funding where markets cannot do so and work in conjunction with other measures. Even if the response to these measures is often very rapid, their effectiveness to foster real growth remains unclear. Furthermore, they can be constrained by the availability of external assets or

foreign-currency credit, the degree of monetization of the economy and the depth of the financial market.

Fiscal policy can act as a countercyclical instrument designed to drive the economy to its level of potential growth; its effect is normally observed over a longer period of time than monetary measures. They usually come in two modalities: tax cuts or subsidy increases. Other actions that also have a positive effect on demand over the medium-term include trade policy (through changes in tariffs, import restrictions or export financing), sectoral policy (aimed at specific sectors, such as agriculture, small- and medium-sized enterprises (SMEs), tourism, industry and construction.) and social/labour policy to assist those that are suffering more from the economic downturn. The implementation of these measures, however, may have an adverse effect on public accounts; if they are financed by new public debt, the already high liabilities of the economies of the region may increase; lastly, they may put pressure on external accounts, leading to an unsustainable twin-deficit situation . Even though their outcome is not observed instantaneously, they have a strong effect on domestic demand and serve as essential compensatory measures.

Lastly, there are other actions that do not present many immediate benefits, but that instead contribute to the long-term growth of the economies. These include spending on infrastructure; development of education and health systems; explicit policies of capability-building directed not only at education and training but also at nurturing and shaping specific corporate actors; essential structural reforms (electoral, labour, energy and others) and promotion of regional cooperation and integration.

The challenges ahead and the role of ECLAC

The framework of stability and economic dynamism that prevailed during 2003-2007 is changing significantly. External constraints on growth that appeared to have been overcome have reappeared with force. The asymmetries between extreme capital mobility and lack of regulation of financial markets, on the one hand, and rigidities in the production structure, its limited diversification and dependence on static comparative advantages in the production of resource-intensive goods , on the other, threaten economic growth and development in the region. Given the acute inequality in income distribution, this economic downturn could severely damage the progress previously achieved towards democratic forms of government.

Linked to these pressing concerns there is the need to review global agreements. In this context, the Secretary General, Ban Ki-Moon, has reasserted the undeniable role of the United Nations as a universal forum in providing global public goods related to development, such as financial stability, global human health, food security and climate stability. Reducing inequality requires advancing towards a knowledge- and innovation-based society and one that affords full access for all to quality education. All this means finding a new balance between State, market and citizenship. There are four lines of this legacy that can be of interest: first, the importance of the creation and reinvention of institutions, whether public or private, solidarity-based or community-related; second, the development of better forms of organization and evaluation of public governance to

ensure accountability and transparency; third, it should be noted that this institutional redesign refers to institutions at the national, local and also international levels; lastly, underlying this task is the construction of what ECLAC called the "fiscal covenant", that is, the construction of explicit or implicit political agreements on the level, composition and trend of public spending and financing.

ECLAC remains committed to supporting the countries of the region in broadening their concept of development in a way that is truly sustainable in every respect through a more virtuous combination of applied research, technical cooperation and training. Its strong convening authority at the regional level is an important element in this task. The above-mentioned analytical and political capabilities and convening authority gain special importance in the current economic conditions prevailing both at the global and the regional level, and are of great value in creating effective consensus on crucial matters in the region. Some of the latter are, to name a few, the coordination of proposals for macroeconomic management through counter-cyclical policies; the promotion and management of trade agreements based on the concept of open regionalism; the modernization of productive structures focusing on the real economy and in technology and innovation; the urgent and far-reaching revision of the role of the State, and the coordination of efforts leading to better adaptation to climate change and mitigation of its effects.

In the past, ECLAC has noted that notwithstanding the overall success of industrialization, a number of setbacks persist: unsatisfactory international integration: recurrent external bottlenecks, low and unstable growth, unemployment, underemployment and poverty, and a widening gap in wealth and income levels between the centre and the periphery. In the new context, the current message is similar. However, instead of championing industrialization as the only engine of growth and technical change, the new strategy for structural change advocated by ECLAC is conceptually linked to the ideas of production and export diversification by adding value through innovation and broadening and strengthening productive structures.

The recent analytical frameworks developed by ECLAC convey this same idea enhanced by the prospect of the opportunities created by multiple paths for technical progress in several production sectors based on the production specialization structure of the countries, beyond that of the manufacturing sector. Failure to implement a strategy for structural change will mean that the region will remain insufficiently integrated with the global economy and will experience increasing difficulties in competing with Asian countries, will face external bottlenecks hindering growth, insufficient creation of quality jobs, difficulties in overcoming poverty and growing inequality, and increasing divergence in relation to the developed nations.

Although ECLAC has adapted its thinking to the new environment, the analytical concepts used in its early days remain fully valid. Indeed, its recent intellectual interpretation related to economic growth and international trade represents a progression in the analysis and systematization of empirical knowledge and builds upon its classical analytical framework. In other words, the knowledge production demonstrates

enhancement of the traditional structure and has been adapted to the current era of globalization.

A seven-point agenda for Latin America centred on the real economy

So far, the response to the crisis has focused on unlocking credit and preventing extensive damage to the real economy. However, in any market-based economy, there are a few sectors that can damage the entire economy, or worse, bring it to a halt. The most important are energy, transportation, finance and telecommunications. The impact of business cycles and crises on the real sector has been frequently analysed in terms of aggregate variables: output, employment and demand. However, there are also microeconomic implications which influence economic development. Thus, it is time to rethink the institutions and rules governing the financial markets as well as the policies in the fields of technology and industrial diversification, particularly in catching-up economies. More specifically, all the reasons in favour of intervention in the financial system are also present in the industrial system, and adoption of correct policies for the development of technological capabilities cannot be neglected in times of financial crisis – on the contrary, they are more necessary than ever.

The following seven-point agenda, centred on the real economy, is put forward as a non-exhaustive list for Latin America and the Caribbean:

1. The financial crisis entails more than a systemic impact on aggregate macro variables. It leads to the recomposition of the microeconomic structure, which in turn shapes the response of the economy to the crisis.
2. In crisis situations firms and sectors readapt their capabilities, learning processes and production and investment strategies. The production structure undergoes restructuring, which may imply the destruction of certain productive, technological and human capabilities.
3. Industrial and technological structures are no less systemic than finance: network and domino effects are present in the real economy as well. Stickiness in production and technological capabilities implies that these effects are less easily reversible in the real economy than in financial markets.
4. Capabilities in new paradigms in science, technology and production will lead the emergence from the current crisis, and will determine the repositioning in the global economy.
5. Facing the crisis means thinking about the future: the need “more than ever” for active industrial and technological policies.
6. A smart policy mix: measures to avoid the destruction of production and technological capabilities and new incentives for the accumulation and adoption of new technologies.

7. Dealing with uncertainty: the need for technology foresight to provide a comprehensive overview of future production paradigms, bringing together in partnership scientists, engineers, industrialists and government officials.

Final remarks

The fundamental question arising now is how to strengthen the links, historically so elusive in the region, between economic development, social development and environmental sustainability. It must be recognized that these three dimensions are equally important and should progress in a parallel and mutually reinforcing way.

Latin American economies are expecting a significant slowdown in economic growth in 2009 which is not expected to rise above 2 percent; after five years of steady growth. Whereas the crisis initially seemed to impact only the countries which are more integrated into the international economy and financial markets, such as Argentina, Brazil, Mexico, Chile and Colombia, it is now foreseeable that in the fallout from the new phase of the crisis commodity prices will be affected. This would significantly hurt Argentina, Bolivarian Republic of Venezuela Bolivia, Peru and Ecuador. Conversely, as Central America and the Caribbean are net importers of commodities, the fall in commodity prices would alleviate and partially offset the consequences of the world economic slowdown.

Designing coordinated responses to address the current economic conditions means actively seeking complementarities between growth and equity, between competitiveness and social cohesion, between the these two pairs and democratic development; lastly, between economic development and environmental sustainability. We are aware that these goals are often conflicting and that they generate multiple policy dilemmas. However, we must find creative ways to achieve them simultaneously in the medium-to-long term.

Therefore, the response adopted by any given country to the current global financial crisis must entail the ethical responsibility to recognize and strengthen the interrelationships between the economic, social and environmental policies, coupled with the equally-important democratic progress in the region. This is crucial in the current context of uncertainty about the economic and social benefits of democracy, global economic integration and the uneven progress towards regional and sub-regional integration.

THE GLOBAL FINANCIAL CRISIS: IMPACT AND RESPONSE OF THE REGIONAL COMMISSIONS

Economic and Social Commission for Asia and the Pacific

Impact on the region

For the second time in a decade the Asia-Pacific region has been hit by financial crisis. However, this time the source of crisis is from outside the region. The region is better prepared for currency and balance of payment crises than it was a decade ago, having instituted wide ranging reforms, improved current account balances and built up a protective shield of foreign exchange reserves. Notwithstanding this progress, high levels of financial, trade and investment integration with the global economy leave no country immune to these events. Consequently, the global slowdown arising from the crisis has exerted significant downward pressures on growth in the region with attendant social consequences that are still unfolding. There are a number of potential financial vulnerabilities that raise concerns and need to be tracked carefully as the crisis unfolds.

First, the spark that has led to immediate macroeconomic difficulties for some economies of the region has been, once again, exposure to short-term portfolio capital. The share of the stock of foreign portfolio capital in the stock of external financial liabilities has grown significantly for some countries in recent years. During times of generalized international risk aversion, when short-term portfolio capital exits developing countries, efforts aimed at preventing excessive currency depreciation reduce the availability of reserves to cover external short-term debt repayments and current account deficits in some countries.

Another potential vulnerability stems from the banking sector. Although most economies in the region possess adequate reserve cover for external short-term debt at the national level, banking sectors in some cases may run the risk of being overly dependent on foreign sources for their lending. Total banking loans in a few countries are notable for substantially exceeding total domestic deposits, thus increasing the reliance of banks on funding from foreign sources, often comprising short-term loans. The global credit crunch may result in banks coming under increased stress in continuing to fund their banking activities.

A third source of vulnerability is the region's dependence on trade and investments with developed countries. Highly export-dependent economies such as those of East and North-east Asia as well as South-East Asia will inevitably be more affected. Even though intraregional trade has been growing impressively, it generally consists of parts and components in the manufacturing sector. To a large extent these exports are linked to demand for final consumer products in developed countries. Developed country recession will therefore transmit its way back to the region through the channel of trade and investments.

Against this grim backdrop, the forecast for developing economies in the region is a slowdown in growth to 5.7 per cent in 2009 from an estimated 6.8 per cent in 2008, with significant downside risks. The pace of deceleration will depend on the extent to which domestic and regional demand can offset the setback in exports destined for

developed markets. Countries with special needs, such as landlocked and island countries, although not highly integrated with the global economy will also be hard hit as their special circumstances weaken their coping mechanisms. As the fiscal stimulus packages introduced by countries such as China, the Republic of Korea and Japan work their way through the respective economies, it is expected that aggregate demand in the region may be somewhat cushioned through an increase in intra-regional trade, although a delinking from the rest of the world is unfeasible, nor would it be a sustainable option.

The increasing spill-over effects of the global financial crisis into the real sectors, combined with long term challenges posed by climate change, and huge volatilities in food and fuel prices have all converged to pose a grave challenge for the Asia-Pacific region. In particular, there is the risk that progress towards the Millennium Development Goals in the region could be reversed significantly. It is estimated that the region has some 900 million people living below the revised poverty line. Another 583 million people are undernourished. Forty-six percent of all children in South Asia and 29 percent of children in South-East Asia are underweight. All indications suggest that the financial crisis will exacerbate this situation.

This unprecedented convergence of crises has driven home a stark reality that for all its achievements, this region is under stress and more fragile than thought possible. The suffering of millions brought on by the year's financial, food and environmental disasters is but a symptom of a larger global problem, the magnitude of which is still unfolding.

A number of questions arise. Have we evolved the global financial system, with its complex and opaque interplays between financial demanders and suppliers too fast? Has it gone too far? Have we run the regenerative potential inherent in our ecosystems to the ground? Are the wealthy living beyond their means? Have we created social inequities that can never be corrected and will delay the achievement of the MDGs by the target date? Has the world reached its critical threshold in stress endurance?

Due to the convergence of crises, compounding effects must be taken into account in devising policy responses. Policy actions that address one crisis may deepen another crisis, and these tradeoffs should also be taken into account. Thus, there is a strong regional sentiment on the need to agree on policy solutions that are durable, comprehensive, global and long term. The unprecedented convergence of these crises provides a unique opportunity to reorient economic growth towards a long term development path that is inclusive and sustainable.

Impact on ESCAP activities

In the past, given the increased trade orientation of the region, the focus of its analytical work remained on its trade policies, and not on financial or monetary policies such as exchange rates. Financial and monetary policies remain at a much more infant stage. The increasing severity and frequency of financial crises will bring about major changes. Consequently, the ESCAP Secretariat has been at the forefront of addressing how this year's global financial developments could impact the Asia-Pacific region. At the institutional level, ESCAP repositioned itself and made changes

to its structure so that macroeconomics, along with disaster management and ecologically sustainable economic growth, now plays an even larger role in ESCAP's services to the region.

In terms of advice to our member governments, the Secretariat has provided a range of key analytical inputs to policymakers both in the years leading up to the crisis and as the crisis hit with full force in 2008.

The Executive Secretary in her first appearance before the UN General Assembly in October 2007, made a presentation on the subject of "Managing Financial Flows for Inclusive and Sustainable Development in Asia and the Pacific." The Executive Secretary highlighted the increased vulnerability to crisis emanating from financial volatility and the need to manage the impact of short-term capital flows. At its Commission Session in April 2008, a high level policy discussion was organized which raised the alarm on the potential consequences of the financial crisis on Asian developing economies.

The Executive Secretary also sought to look beyond the financial crisis to the food/fuel and climate change crisis, and policy implications arising from this unprecedented convergence of crises. Thus the focus of Economic and Social Survey of the Region 2009 will be placed on "threats to development" and their convergence. Furthermore, together with the Government of Indonesia, a High-level Regional Policy Dialogue on "The Food-Fuel Crisis and Climate Change – Reshaping the Development Agenda" was organized in Bali in December 2008. The two-day event was the first time that the issues of the food, energy and financial crises, and climate change, were addressed in a comprehensive and integrated manner in the Asia-Pacific region. Recommendations from the Dialogue, as contained in the "Bali Outcome Document", serves as a framework for ESCAP actions to address the impact of the crises on our region. Finally, the theme topic for the 2009 Session of the Commission is on sustainable agriculture and food security.

In line with the above, and the analytical and normative role of the regional commissions, the ESCAP Secretariat will serve as a forum for exploring policy options and forging consensus on regional policy coordination. In an effort to see the region emerge from crisis-resilience to crisis-resistance in future, some of the key directions in which the secretariat's future work related to the financial crisis will proceed are the following:

1. The reform of the global financial architecture. This issue is currently under intense debate and the political momentum generated by the G-20 leaders ensures that this issue will remain at the top of the international policy agenda for some time to come. The Asia-Pacific region could expect to have an increasingly influential voice in shaping the future multilateral economic and financial governance, commensurate with its rising contribution to global economic stability and prosperity. The Secretariat will provide the forum in which countries can debate the policy options and coordinate their views.
2. At the regional level, a largely neglected debate concerns the formulation of effective and coordinated macroeconomic policies to move the region from crisis-resilience to crisis-resistance. Pressure to undertake currency devaluations in the

current environment of export difficulty would result in beggar-thy-neighbour competitive relations to the detriment of all in the region. Closely related to this is the difficult challenge of how to manage vulnerability to reversals in short term capital flows. The Secretariat will encourage consensus building on establishing more coordinated and durable regional exchange rate arrangements.

3. Of equal concern for Asia-Pacific is the need to establish a regional contingency plan that would have sufficient resources to respond quickly to liquidity and capitalization problems of domestic banks. Recent events show that purely domestic actions can raise the risk of adverse consequences in neighbouring countries. However, this would require an accelerated establishment of a regional surveillance system that focuses on emerging risks. ESCAP is well positioned to assist its subregional development partners (for example the ASEAN secretariat) in filling in and analyzing, in a neutral way, large information gaps that exist in tracking and assessing systemic financial risk. As a first step, a database of financial indicators has been set up to track the performance of these indicators.

4. Given the importance of trade as a driver of economic growth and development and, hence, as a major source of finance for development, the Secretariat is continuing to promote intra-regional trade with focus on South-South trade, with the purpose to diversify trade both in terms of products and services and markets. The global financial crisis has put enormous pressure on Asia-Pacific exporters to increase competitiveness to exploit rapidly declining export opportunities. ESCAP is continuing to call for a strengthening of the multilateral trading system, including an early and successful conclusion of the Doha negotiations, as this system offers the most stable and transparent environment to conduct global and regional trade. Furthermore, the Secretariat, through its trade facilitation programme that focuses on analytical and capacity building work, is working closely with countries in the region to strengthen national and regional trade capacity in order to reduce the cost of trade.

5. Public trust and confidence in business and the workings of markets has been seriously eroded. Insufficient respect for values that encompass ethical dimensions while addressing profitability is, at least in part, responsible for the confidence crisis. Thus the overriding priority at this stage is to restore confidence in markets and the financial system as a whole, and shifting the focus from short-term profit considerations to long-term sustainability. The integration of economic, social, environmental and governance issues into corporate management and operations assumes increased importance. With this crisis comes an opportunity- to move towards responsible investment, where decisions on investment are not just about returns but are based on a long-term vision of ensuring health, productivity and a sustainable economy and society. The Secretariat is working closely with the Global Compact office in New York to build business-driven, vibrant and sustainable networks in the region that help business to make a paradigm shift.

6. The curtailment of trade has been exacerbated by the lack of trade credit. Somewhat anomalously for this trade-oriented region, it is the only one that does not have a regional institution specifically dedicated to export credit and export credit guarantees. A regional response would enable risk pooling across countries, capital pooling and scale economies. Actions at the regional level are more credible and therefore enable greater market outreach and access to international finance. Under

these circumstances, the Secretariat will support through analysis and policy dialogue the establishment of a regional trade financing facility.

7. As the 1997 crisis showed, the brunt of the crisis is likely to fall on those least able to cope. In any situation where people are affected by sudden shocks, it is the poor, many women, the youngest and oldest populations and socially excluded groups which are the hardest hit. The Secretariat will mobilize attention and renew policy action on the setting up of adequate and sustainable social protection systems.

The Impact of the Global Financial Crisis on ESCWA Economies

1. The global financial crisis is affecting the ESCWA Region in several ways, including through decreasing overall financial wealth and lowering economic growth prospects.
2. Financial wealth in the region, in terms of stock market capitalization, significantly decreased in 2008 and the real estate market slowed significantly in the 4th quarter of 2008. The largest and immediate impact of the crisis was seen in the financial markets. The indices of the stock markets in the region were hardly hit through the spill over from the free fall of the global stock markets. The sharp drop varied from over 67 per cent in Dubai to over 55 per cent in Saudi Arabia and Egypt. The total loss in market capitalization was estimated at over \$500 billion.
3. As crude oil prices collapsed from the historical high level of July 2008, the region's fiscal and economic growth prospects have been facing severe downward correction. The price of oil dropped from its peak of about \$147 in June 2008 to below \$50 in recent weeks. This will have a major impact on the oil revenues particularly in the major oil exporting countries, which in turn will affect their public spending. At the same time, the drop in oil prices and revenues will affect the capacity of the major oil exporting countries in the region to provide official development assistance to other developing countries, which together with the expected decline in ODA from major industrialized countries would lead to a decline in the ODA inflows to developing countries in the region and outside.
4. As international money and capital markets became frozen, the effectiveness of monetary policy has been in question. The government sector's strategic fiscal expansion to sustain domestic demand for growth has been required in most developed countries. The governments of ESCWA Region have so far pledged fiscal stimulus packages to sustain their respective economies, but several countries in the region are facing a fiscal constraint to do so.
5. There is a loss by the sovereign wealth funds which is still not yet adequately estimated.
6. The expected slowdown in global demand will be translated into a global recession. This, in turn, will lead to lower FD, drop in tourism, workers' remittances and ODA inflows to the region.
7. Any restrictive fiscal policies by member countries to try to mitigate the impact of the financial crisis would negatively affect the efforts of these countries to achieve the MDGs; therefore, it is necessary for these countries to keep a sustainable fiscal expansion to achieve the MDGs. International financial institutions may request tighter fiscal spending by developing countries including ESCWA member countries. However, the

budget related to the MDGs should be preserved. International assistance, in form of direct fiscal assistance, should be required to safeguard the MDGs.

8. Moreover, the financial crisis has led to increased unemployment in the region, particularly in Dubai's real estate sector. During this phase of employment adjustment, it is the expatriate labour in the region that is the most vulnerable. Retaining expatriate labour, particularly of skilled classes, will be beneficial for the host countries in the region, but the present state of financial crisis is forcing the private sector to layoff those potentially beneficial expatriate labourers.

Actions being taken by ESCWA

9. Daily monitoring of the situation is conducted and a database has been compiled for further in-depth analysis.
10. An interdisciplinary approach has been considered critical as the effect of the financial crisis will be not on the region's financial sector only, but the economy and social structure at large (e.g. growth, MDGs, expatriate labour, migration).
11. A paper is being prepared to analyze the impact of the crisis on the financial markets in the ESCWA region.
12. The regional commissions, including ESCWA, are in an ideal position given their convening role to coordinate a regional response, in cooperation with regional bodies including the League of Arab States and regional development banks.