

Briefing for Member States on “The IMF and low-income countries in the context of the Millennium Development Goals” (organized by the Office of the Special Representative of the International Monetary Fund to the United Nations)

The afternoon’s talked spanned the following general themes:

1. Is there any inconsistency between what countries economic policies are and what they should be in order to reach the MDGs?
2. How has the IMF contributed to the MDG effort over time and what is they way forward in the context of the macroeconomic perspective of developing countries and the challenges they face?
3. How are low-income countries emerging from the crisis and what policies they will need to implement to get on a sustainable path to strong growth?
4. What is the IMF doing to help them get there?
5. What are the challenges linked in various ways to achieving the MDGs?
6. Looking beyond 2015 – what we need to do to reduce poverty even after the expiration of the MDG timeframe.

The speaker began by describing the IMF’s role, especially in the wake of the crisis, as helping countries return quickly to sustainable growth trajectories; stepping up social protection and investments; and investing in economic infrastructure.

Some of the challenges the organization faces in wake of these goals include protecting against future shocks; domestic resources mobilization and expenditure efficiency – helping build domestic resources bases especially for low-income countries (LICs) that are heavily dependent on foreign aid, and well as advising them on safe use of external finance; and managing the aid/debt resources of development finances.

In describing the impact of the crisis on LICs, he remarked that the shocks have been extremely severe. However, this is the first time that many LICs have been able to implement Keynesian countercyclical policy responses, which is a great milestone in terms of their growing economic resilience relative to previous years. He mentioned that although many countries have rung up more debt, the debt remains manageable for most of them

How did the IMF respond?

In looking beyond the crisis, he spoke of challenges involving managing volatility, rebuilding policy buffers (policy positions that will protect economies against future shocks), investing for growth, and the implications of evolving aid architecture (seeing as private finance is become as or even more important than traditional sources of aid)

The global financial and economic crises, he remarked, hit the LICs hard, and major transmissions channels of income to these countries, i.e. exports, remittances, foreign direct investment (FDI) saw dramatic declines while credit facilities (including trade finance) tightened considerably. He mentioned that previous crises typically involved shocks to interest rates or terms of trade (TOT). However, this crisis was primarily transmitted through world trade, coupled with associated shocks to finance (FDI etc became scarcer and more expensive).

He observed that growth had dipped more sharply in previous crises. However, this crisis showed a dip from a higher pre-crisis level, as LICs were growing at their fastest rate in many decades). Additionally, the overall decline in growth rates for LICs was less than the recorded world average. Usually, recovering from crises in LICs is drawn out. Typically, while the rest of the world recovered quickly, LICs would take longer, with less significant recovery. The 2009 crisis, however, showed that LICs did not experience a terrible drop and have recovered fairly quickly.

Speaking on the changes in LICs ability to employ Keynesian policies in response to the problems posed by the crisis, he said that most LICs went into crisis with much stronger macroeconomic positions; many had achieved macroeconomic stability, had stronger institutions, lower debt, and had built room for themselves for countercyclical policy responses.

On IMF response to the needs that arose in wake of the crisis, he revealed that the organization supported larger fiscal deficits as part of global fiscal stimulus; As the crisis hit in 2009, revenues dropped sharply, expenditures increased (increase government expenditure) and fiscal balances deteriorated.

Countries with the strongest policy buffers implemented the largest fiscal expansionary policies while those which had not accumulated those policies had to cut expenditure.

There was a similar portrait for monetary policy, he said.

The crises worsened debt ratios but should not, he believed, result in systemic debt problems across LICs should there be no permanent impact on growth and LICs progressively undo fiscal easing implemented during the crisis.

IMF response

2009: IMF more than tripled support for LICs to 3.8 bil

Concessional lending capacity doubled to \$17 billion through 2014, financed partly by gold sales.

Allocated a \$250 billion new set of Special Drawing Rights

Zero interest rates on all concessional credit

Support of countercyclical programs.

Comprehensive 2009 reform:

More flexible facilities in poverty reduction and growth trust to meet diverse LIC needs

Creation of short-term, medium-term and emergency support for nations

Access to financing doubled

Zero interest through end of 2011

Permanently higher level of concessional lending

Conditionality made more flexible

Support country owned PR strategies

Explicit safeguards to social spending

Structural conditionality more focused on macro critical areas

Binding structural conditions and wage ceilings abolished

Debt limits more flexible to meet infrastructure gaps

Managing volatility

Achieving MDGs depends critically on minimizing further disruption to growth – avoiding large swings and downturns in growth. LICs are more prone to shocks than advanced countries and the better placed they are in terms of macroeconomic policies, the quicker they can come out with less damage to their economies.

Exposure will grow further with global integration and climate change (LICs are substantially more vulnerable to climate change due to their heavy dependence on agriculture and fossil fuels) LICs are generally under-insured both in terms of private insurance, natural disaster protection and policy protection.

However, the cost of holding reserves as a cushion for these potential shocks is high. Hence, the alternative would be to implement policy buffers and improved access and availability of concessional support.

How to Rebuild Policy Buffers (in wake of the recent crisis):

- First, do no harm. Avoid premature or overly rapid fiscal tightening. Crisis is not definitively over and coming out of it at different speeds. So they need to be careful about the pace at which they rebalance their fiscal policies.
- When strengthening fiscal positions focus on revenue growth and preserve priority spending. Help reduce deficits etc while maintaining room for expenditure
- Borrow for high-return investment: needs careful management. Interest arbitrage and hedging needs to be done carefully.
- Avoid overreliance on debt-creating capital inflows; develop local savings and financial sectors.

Investing for Growth:

There is currently a massive infrastructure deficit especially in Africa – key growth bottleneck.

This has been neglected over the last decade, as there's been a lot more focus on spending in social sectors. Needs to be addressed over the next few years.

LIC governments rightly keen to scale up public investment.

Quality is critical – strengthen public finance institutions.

Evolving aid architecture:

Can traditional donors deliver finance? Some donors have begun to cut their aid budgets, and others have reducing prospects to increase aid over the next few years.

Aid is holding up, but not meeting the Gleneagles commitments, particularly to Africa.

Realistically, huge investment needs will require non-concessional credit.

China is becoming largest bilateral donor in Africa. However, their help is typically more expensive so this needs proper management. Coordination of not just of financial but all forms of aid is important to ensure the nations receive what is in their best interest.

Need to tap private finance more effectively. LIC economies with promising growth prospects should be able to tap more private investment as attention shifts from the advanced economies.

Climate change financing needs

The IMF does not necessarily adopt a primary role in face of climate change, in terms of policies. But in terms of macroeconomic policies, the IMF recognises that LICs face a potentially hazardous situation. Climate change is a global challenge, but has uneven impact on different areas. LICs have contributed the least to climate change inducing factors, but may be most affected. Need large scale, long-term investments for adaptation/mitigation.

“Green fund’ idea was advanced by the IMF as a bridge to overcome collective problem – idea is to mobilize resources on a large scale using capital from developed countries, channel and centralize the collection of the money, then supervise the channeling of this money to developing countries. Has been fed to UN high-level climate group.

Provide \$100 billion/yr by 2020 for the green fund.

Following his presentation, the floor was opened for questions.