SPEED THE FLOW OF MONEY TO POOR COUNTRIES

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Framing the Issue

The last time the G-20 met, the talk was of the collapse in rich country economies. Emerging markets were seen as "still experiencing good growth but as being increasingly impacted by the worldwide slowdown." Poor countries were not mentioned. In 47 items listed in the Action Plan, the only one really relevant to poor countries was a lukewarm commitment by leaders to "review the adequacy of the resources of the [International Financial Institutions] and stand ready to increase them where necessary."

What a difference a few months make. The talk today is of a development crisis and emergency. UNESCO, the IMF, the World Bank and the Asian Development Bank have all come out with reports in the last month suggesting the impact on low-income countries will be far greater than expected, as commodity prices, trade, remittances and infrastructure project finance dry up. The official forecasts for growth in Africa have been almost halved to 3.5 percent for 2009, and some predict further slowing in 2010. Per capita income growth in Africa is expected to virtually stop. UNESCO goes further in suggesting a 20 percent decline in incomes for the 391 million Africans living on less than $1.25 per day, the new international poverty line. It goes on to add that infant mortality could increase by between 200,000-400,000 a year. The World Bank predicts an extra 46 million people in poverty in 2009.

Prospects for poor countries have soured quickly because they are more exposed to capital stops than had been thought. The depth of the crisis has meant that even sources of finance that were considered safe have proven to be at risk. Trade credit, which underpins about $2.8 trillion in cross-border transactions each year, has shrunk by 40 percent in the last quarter of 2008. About one quarter of new infrastructure projects in developing countries has been delayed or canceled, even though financing had earlier seemed secure.

It is not surprising that private capital would shift away from low-income countries as international banks feel the liquidity squeeze at home. It is more disappointing that official capital flows to poor countries—official development assistance—are also declining. These flows, already tiny at an average of less than 0.3 percent of the rich countries GDP, are shrinking in absolute value in the face of political pressures to contain budgetary spending. What is more, their value is falling as the currencies of the most generous donors, like the Scandinavian countries, depreciate. Currency movements by

themselves could reduce the real value of aid by $4 billion in 2009.

Grim though they are, these statistics do not persuade everyone that the rich world should do more. Even African voices, like Dambise Moyo in her new book "Dead Aid," suggest the continent should be more self-reliant. That may have a grain of truth behind it, but the reality is that a recession is not the time to become virtuous about financial independence.

In fact, the world should worry about the effects of the crisis on poor countries because the consequences for growth, development, children's health, and civil war will be much more expensive to manage than the cost of preventive aid now. There is ample research that shows that the frequency and depth of downturns is more important for long-run average growth in poor countries than growth accelerations. Almost all countries have accelerations at some point in time. What differentiates successful developers is that they are able to minimize the size of downturns.

In other words, growth in poor countries is not symmetric. The costs of slow growth are larger than the gains from rapid growth. This asymmetry shows up in many development indicators. For example, infant mortality tends to rise during recessions but does not return to previous levels during the ensuing recovery.

One channel through which this asymmetry works is civil war. Paul Collier, the pre-eminent scholar on the economics of conflict, estimates that each percentage point decline of growth is associated with a one percent increase in the probability that a low-income country will be embroiled in civil war within five years. If the crisis lowers growth in Africa by 3 percentage points on average, it will raise the probability of civil war for each of 48 sub-Saharan countries by 3 percent. And we know that the costs of responding to conflict are many-fold greater than the costs of aid to prevent the conflict in the first place.

Policy Considerations

The key issue is how to get more resources to low-income countries so they too can implement a fiscal stimulus. The World Bank estimates that only one quarter of vulnerable developing countries are in a position to expand their fiscal deficit or undertake significant countercyclical spending. The IMF is of the same view. Based on this analysis, the Bretton Woods institutions have urged poor countries to limit their additional spending to any incremental concessional finance they can raise. Both the Bank and the Fund have promised to help raise such funds, with President Zoellick calling forcefully for rich countries to contribute 0.7 percent of their stimulus packages into a Vulnerability Fund for poor countries.

The problem with this approach is that it is not yet working and may be too slow given the urgency of the needs. The key issue is to make more money available without conditions that poor countries find too onerous. Because of worry about debt levels in poor countries, the IMF has lent only $260 million

from its concessional resources to six low-income countries over the last six months, for an average of 35 percent of quota for each program. Contrast this with its much larger programs for eight middle income countries, to whom the Fund has lent $46.1 billion (650 percent of quota). The International Development Association (IDA) has indicated it is willing to front-load credits and grants, but only if countries agree to cut back in 2010 and 2011. There are few takers. As a result, IDA only managed to commit $4 billion in the second half of 2008. Without resources, no poor countries have been able to undertake fiscal stimulus.

It is the wrong choice to make poor countries adopt fiscally conservative postures at a time of a global crisis of this magnitude. It is time to recognize that low-income countries have made considerable strides in improving macroeconomic performance over the last decade and can be trusted to do better now. The World Bank's own analysis suggests 70 percent of developing countries have a high- or medium-level of administrative capability to respond effectively to the crisis. Thanks to debt relief programs like the Heavily Indebted Poor Country Initiative, half of all low-income countries have debt below 36 percent of GDP. Half also have fiscal deficits (after grants) below 1.8 percent of GDP. While it is true that these hard won gains should not be casually reversed, the creation of fiscal space through debt relief was done precisely to provide room for necessary spending. If this is not the appropriate time to use the space, then when is?

The real point is that poor countries need help to expand spending now. That means working through existing structures, rather than developing new ones on the fly. The good news is that there is already a considerable amount of money in the pipelines of the multilateral development banks—perhaps $60-70 billion in committed, but undisbursed funds. This money, for projects which have already been vetted for their development impact, has also been included in rich country budgets. It is not an ask for more.

Action Items for Global Coordination

Poor countries are likely to see a major set-back to development progress in 2009. Rich countries should do their best to minimize this set-back in their own self-interest. If they do not, they will be called upon to confront poverty, health and perhaps conflict crises and will see infrastructure assets that have been painstakingly built up deteriorate for lack of maintenance. "A stitch in time saves nine" is true for development.

The focus of attention should shift from calls for new money—the commitment culture—to speeding the flow of money—a disbursement culture. Such an approach would allow poor countries to join the rest of the world in stepping up fiscal expenditures to protect their citizens and their economies. A global crisis requires a global solution—there is no reason to leave poor countries out just because they are small in global terms.