General Assembly
Ad Hoc Open-ended Working Group to follow up on the issues contained in the Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development

Fourth meeting on
"Access to credit and concessionary finance; fiscal space for countercyclical policies; and the current global reserve system"
(New York, 30 April 2010)

Informal summary by the Secretariat

Overview. The meeting was co-chaired by H.E. Mr. Lazarous Kapambwe (Zambia) and H.E. Mr. Morten Wetland (Norway) who introduced the theme of the meeting, which was based in particular on paragraphs 12-14, 16-18 and 35-36 of the Outcome Document, with the focus on assessing new lending facilities from international financial institutions in response to the crisis, concessionary finance, the modernization of conditionalities and other issues related to global liquidity and financial stability, including the use of Special Drawing Rights (SDRs) and the current global reserve system. The presentations and discussion also addressed the extent to which developing countries had regained access to credit from private sources and the key obstacles they had faced at the national and international levels in seeking the fiscal space to enact countercyclical policies.

Summary of the presentations by the panelists

Mr. Daniel Titelman, Chief of Development Studies Section of the Economic Commission for Latin America and the Caribbean (ECLAC), in his presentation addressed access to international financial flows in Latin America and the Caribbean. He noted that although during the period 2003-2007 LAC economies experienced good macroeconomic performance, the global crisis caused one of the most severe declines in GDP in over three decades and the sharpest episode of growth deceleration since the 1980's. The good news was that the combination of policy activism and more favorable external conditions was expected to support a rebound in LAC economic activity in 2010.

He noted that some countries announced increased fiscal spending for 2009, but not all had the same financial and fiscal institutional capacity to adopt counter-cyclical policies. This reflected the heterogeneity of the region and underscored the need to increase institutional capacity and help in financing countercyclical policies.

He added that all types of international financial flows - portfolio, foreign direct investment (FDI) and remittances - to the region experienced a significant reduction as a consequence of the crisis and that the reduction of net financial flows took place at the same time that the risk perception of the LAC economies increased. The reduction in remittances was critical for many LAC in particular in Central America. However, since the last quarter of 2009, LAC economies had restored access to international financial markets, but capital inflows remained below pre-crisis levels. An important feature of the recent financial inflows was that high rate of growth of often most volatile portfolio investments, particularly bond issues and syndicated loans. This opened up issues related to exchange rate, financial stability and the use of capital controls. For

2010 and 2011, it was expected that private financial flows to LAC economies would experience a significant increase, in particular the FDI component.

The presenter highlighted that unlike in past crises, international financial institutions assisted several LAC countries rather expeditiously during the current crisis. The IMF granted financial assistance to several economies in the region with more flexible conditionality. The World Bank also increased loans and introduced more flexible instruments to help countries during the crisis. Regional and sub-regional financial institutions also played a significant role in the region by providing credit at more flexible conditions, particularly in helping finance liquidity needs of small countries. Additional financial assistance to Central Banks in the region precautionary needs (episodic support). In addition to structure changes, there were changes to global access limits and norms and more concessional support for LICs.

With respect to Macroeconomic Policy Design, Mr. Harris noted that there was an emphasis on social spending and on poverty reduction and better ta affected non-sovereign ratings and included a broad range of political, legal, economic and industry factors since it was the aggregate of the specific risks involved in doing business with a particular country. The speaker emphasized that sovereign credit ratings and country risk were highly correlated in that sovereigns with the lowest risk tended to be in countries with the least country risk, as evidenced by stable political systems, well-developed legal frameworks and open, market-oriented economies.

The sovereign rating methodology would take into account credit and political factors. Credit factors included the income and economic structure, fiscal and monetary policies, debt burdens, liquidity and economic growth prospects. Political factors comprised the stability and legitimacy of political institutions, popular participation, the process of succession, transparency and geopolitical factors. However, she underlined the fact that factors could vary and that the final sovereign rating did not necessarily reflect on each factor individually. For example, a sovereign with a low rating might have a fairly flexible labor market or favorable regulatory structures. There was no “sovereign ceiling” to ratings and sometimes entities within a country would be rated higher than the sovereign when they exhibited sound credit characteristics and were sheltered from sovereign risk factors.

fifth session of the General Assembly. Moreover, the global reserve system could be further complemented by strengthened regional commercial and reserve arrangements.

The representative recalled that the Outcome Document also highlighted fiscal space and the need to close the financing gap, flexibility to implement countercyclical policies, the need to streamline conditionalities and the right to use capital restrictions. In this connection, the BWIs should not impose pro-cyclical policies and conditionalties that limited policy space to promote development. Moreover, multilateral development banks should move forward on flexible, concessional and conditionality free, fast dis

The representative of Switzerland discussed the key international and national factors that shaped fiscal space, noting that in many developing countries, favourable macroeconomic conditions prior to the crisis, provided them with fiscal space in their response to the crisis. Flexible provision of liquidity by the international financial institutions (IFIs) and by bilateral assistance without excessive conditionality played an important role. The challenge was for countries to maintain long-term fiscal sustainability. In this context, the provision of technical assistance to developing countries to address structural challenges, growth objectives and achievement of the MDGs would be needed.

He also noted that the current global reserve system risked high instability in exchange rate and subsidized the interest rate of the reserve currency country. International policies aimed at stabilization of exchange rate could also impede global growth.

The speaker posed a question about how powerful credit ratings were in affecting investment and financial markets and about the criticism of credit rating agencies' contribution to pro-cyclicality of capital flows.

The representative of Mexico asked about the sustainability of the growth pattern in Latin America, which was primarily linked to commodity prices. He also emphasized the importance of ensuring that developing countries could get the financing needed during financial instability, citing Mexico's use of the FCL He posed a question about the guarantees for methodological soundness of credit ratings and about the major challenges in the rating of debt and investment.

The representative of Venezuela asked panelists to elaborate on the potential of sub-regional financial instruments in providing liquidity. He noted the inequity of the current international financial system and called on the use of SDRs to provide international liquidity which could avoid some of the undesirable consequences of bilateral financing. Regional and sub-regional initiatives on reserve currencies needed study. He proposed a technical committee within the Ad Hoc Working Group to address the process of bolstering the role of SDRs in the necessary overhaul of the global reserve system.

The representative of Indonesia noted that even with the institution of the FCL, many countries were still not keen to use the facility because of the issue of dealing with IMF and the stigma of borrowing from it. He put forward alternative mechanisms of crisis financing: 1) flexible instruments for programmatic financing during financial turmoil e.g. an ad hoc mechanism in Asia that helped to reduce capital flight; 2) plans for IMF's role in bilateral swap arrangements. With regard to ratings, he asked about the difference between country rating and sovereign rating and how they influence each other and the frequency of review of ratings.

The representative of Pakistan asked the panelist from the IMF whether enough had been done in providing financing relative to the impact of the crisis. Also, he wanted to know how far developing countries were involved in designing crisis measures and whether response measures were time-bound. Regarding credit ratings, he asked whether rating agencies themselves were assessed. In addition, as developing countries were large investors in developed country government securities, he wanted to know whether investors were involved in the rating process.

The representative of Antigua and Barbuda asked whether there had

Concluding remarks by the panelists

In response to questions from the floor, Ms. Schineller highlighted that ratings were as powerful as markets wanted them to be. The reputation of the rating agencies was a key element in the determination of their influence. However, ratings were only one factor in the investment decision process. Sovereign ratings could change independently of the market. Frequently, there were divergences between ratings and market sentiment. Ms. Schineller recognized that more transparency was important. The overvaluation of mortgage-backed securities had led to a change of ratings criteria that incorporated public input. Procyclicality between market movements and ratings may occur, yet the idea was not to follow the market trend but to look for a consolidated trend based on informed quantitative and qualitative analysis. Rating agencies were regulated by regulatory agencies in their country (for example, in the US through the Securities and Exchange Commission). She further highlighted that the credit outlook for the Caribbean was somewhat more negative than the rest of Latin America, since these countries suffered particularly heavily from the crisis due to their proximity and links to the US economy.

In response to questions from the delegates, Mr. Harris reminded participants that the market determined which currencies were used as international reserves and that it was not something determined by a particular institution or country.

He explained that country assessments were not done at a desk in Washington, but that they were done in particular countries with their participation and never imposed.

With respect to SDR allocations, he responded that it was the institutional view of the IMF that SDRs were not a tool for development financing but were to be used for liquidity purposes and as a reserve agent.

Mr. Titelman also addressed the issue of using different currencies as reserves and in sub-regional arrangements, saying that a currency would have to have a good record of liquidity, be