VOICES OF THE SOUTH ON GLOBALIZATION

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THE UNFOLDING FINANCIAL CRISIS

In this issue

Voices of the South on Globalization is a monthly newsletter intended to inspire a meaningful North-South Dialogue by raising awareness for global interdependences and by offering a forum for voices from the South in the globalization debate. Each edition will present short analyses or commentaries from a Southern perspective on one particular issue of the globalization process.

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WHAT ABOUT THE DEVELOPING COUNTRIES?

Developing countries, at first sheltered from the worst elements of the global financial turmoil, are now seen to be much more vulnerable, with dwindling capital flows, huge withdrawals of capital leading to losses in equity markets, and skyrocketing interest rates.

GDP growth in developing countries - only recently expected to increase by 6.4 percent in 2009 - is now likely to be only 4.5 percent, according to economists at the World Bank. Some developing countries will be hit much harder than the average – experiencing growth which is negative in per capita or even absolute terms.

Real GDP growth forecast for developing regions (%age change from previous year)

Region	2008	2009
East Asia and the Pacific	8.8	6.7
Europe and Central Asia	6	3.5
Latin America & Caribbean	4.5	2.1
Middle East & North Africa	5.7	3.5
South Asia	6.3	5.4
Sub-Saharan Africa	5.4	4.6

Coming on the heels of the food and fuel price shock, the global financial crisis could significantly set back the fight against poverty. A World Bank background paper prepared for the G20 meeting of heads of state held in Washington on November 15 notes that sharply tighter credit conditions and weaker growth are likely to cut into government revenues and governments' ability to invest to meet education, health and gender goals. The poor will be hit hardest.

As a result of high food and fuel prices, some 100 million people have already been driven into extreme poverty. With every one percent decline in developing country growth rates, approximately 20 million more people will be added to this rapidly swelling number.

A preview of the analysis for this year's Global Economic Prospects report shows that real GDP growth will slow down across all developing regions in 2009.

"The direct impact of the crisis is less dramatic in the financial sectors of the poorest countries," said Uri Dadush, Director Development Prospects Group, "but they will be hit nevertheless by slower export growth - global trade is expected to decline by 2.5 percent in 2009 - reduced remittances by migrant workers; and lower commodity prices that will affect commodity-exporting countries."

Like previous crises, this one will hit the poorest people the hardest. Many households, already weakened, are faced with having to sell assets like livestock to survive. Malnutrition could well rise, and school enrolment may well fall. The financial crisis will turn into a human one if the poor are left to fend for themselves.

Economists at the World Bank believe that "social safety net programs, particularly those that are well-designed, are a smart investment both for today and the future". These programs are affordable; Mexico's successful Oportunidades and Brazil's Bolsa Familia cost just about 0.4 percent of GDP. ☑

DEVELOPMENT FUNDING VITAL TO BEAT CRISIS

Two months have passed since the effects of the global financial crisis were first felt in Asia and the Pacific. Much has been said about them. And yet, one of the effects less spoken of is the impact of the crisis on the availability of public and private finance for development, a key issue for the region, where more than 900 million people are living in poverty, writes UN Under-Secretary-General Noeleen Heyzer in a column for the *Bangkok Post*. Heyzer is also Executive Secretary of the UN Economic and Social Commission for Asia and the Pacific (Escap).

Public and private financing for development has been dramatically curtailed, and the simple fact is that Asia-Pacific cannot afford any cutbacks in this respect. With so many of the world's poorest in the region, any reduction will only compound their plight, adds Heyzer.

"To avoid this, we need to safeguard the Asia-Pacific region's hard-fought gains in reducing poverty and promoting development; and we need to continue seeking out new and innovative sources of financing for that development."

Heyezer continues:
In tackling both these tasks, we need to think and act in unison.

The crisis poses a serious threat to the outlook for Asia-Pacific economies. Investment and consumer confidence has been shaken by falling corporate profits, credit squeezes and mounting concerns of job security and reduced household incomes.

The economic growth in our region's developing economies is expected to fall to 6.1 percent next year, from an estimated 7 percent in 2008. A number of countries, including Japan and Singapore, are officially in technical recession.

Our equity markets have fallen sharply _ by more than 35 percent in the Russian Federation, Kazakhstan, India and Indonesia, between mid-August and mid-November. In China, it fell by 21 percent. Of equal concern is the excessive currency volatility seen in recent months. The greatest losses since mid-August have been seen in South Korea and Indonesia, with their currencies falling by more than 20 percent, followed by India at 13 percent and the Russian Federation at 11 percent.

How do we face the global financial crisis and its consequences? The good news is that we are not starting from scratch. The regulatory reforms that were implemented after the 1997 financial crisis and the massive foreign exchange reserves that have been built up since, have provided a cushion to withstand the worst of the fallout.

The events of 1997 also propelled the region to look for mechanisms at reducing its vulnerability to crises. These include the Asian Bond Fund, through which regional central banks have set aside a portion of their reserves in a pool to invest in bonds issued by Asian governments; and the Asean + 3's Chiang Mai Initiative, which provides foreign exchange reserves support through a system of bilateral currency swaps.

However, more needs to be done as many countries are not included in these initiatives. There are also a number of other areas where regional cooperation in financial and monetary matters could be strengthened.
1. The Asia-Pacific region must play a leading role in the discussions on reforming the global financial architecture.
2. We should cooperate in the formulation of effective and coordinated macroeconomic policies at the regional level to reduce economic vulnerability.
3. A regional contingency plan needs to be established to respond quickly to liquidity and capitalisation problems of domestic banks.
4. Consideration should be given to a regional trade financing facility to address concerns that recession in developed countries will significantly restrict trade as trade credit has dried up.
5. Governments must take action to institute or to improve on the delivery of cash transfer programmes and other social protection mechanisms that promote gender equity, and are targeted to those who need it most.

If such measures are not taken, there is a greater probability that the crisis will distract us from the long-term development goals that our region is committed to realising. While several countries have done well in mobilising and utilising domestic and international resources for development _ the region has accumulated foreign exchange reserves in excess of $4 trillion _ this is only a part of the story.

There are many countries, in particular the least-developed countries, land-locked developing countries and small island developing states, which have done less well. In these countries, savings are low and resources are scarce. As a result, investment in basic services such as health and education is far behind the required amount.

World leaders are currently attending the Doha Follow-up International Conference on Financing for Development to review the implementation of the 2002 Monterrey Consensus, which enshrines our collective commitments to eradicate poverty, achieve sustained economic growth and promote sustainable development in a fully inclusive and equitable global economic system.

But realising these commitments is very much dependent on the availability and quality of financial resources and the stability of the global financial system. The current global financial crisis provides an opportunity to take a fresh look at many aspects of the development process that has shaped the world economy. ☑

INDONESIA SAYS 'NO, THANK YOU' TO IMF LOANS

Marwaan Macan-Markar

When the Asian financial crisis struck a decade ago, savaging South-east Asian economies, including Indonesia, Jakarta turned to the International Monetary Fund (IMF) for help in getting the country back on its feet. But now, as a global financial crisis - triggered by the collapse of major United States banks - looms, the mood here is different. Most noticeable is the cold shoulder given by Jakarta to the Fund's offer of some two billion US dollars as a short-term lending facility to meet the growing pressure on the Indonesian economy.

It stems from lingering bitterness over the damage caused to this regional giant by the harsh prescriptions the IMF imposed in its rescue package for Indonesia, beginning in late 1997. President Susil Bambang Yudhoyono conveyed such a sentiment during the recent meeting in Washington D.C. of the leaders of the world's biggest economies (the G-20).

Indonesia will "not follow the IMF's formula in coping with the global financial crisis," the president was reported to have said, according to the local media. "We still need to learn from that experience (of a decade ago)."

It is a view echoed here by National Development Planning Minister Paskah Suzetta, who said, "We will not use the IMF programme, because the problem of overcoming the crisis is not of the balance of payments but on the budget deficit," according to Antara, the national news agency. "The IMF earlier offered to give loans to developing countries, including Indonesia, five times higher than their earlier loans for three months."

Such reservations towards assistance from the IMF are deeply ingrained here because it became clear that "with the IMF's involvement 10 years ago the crisis plunged deeper than necessary," says Rizal Ramli, former finance minister and currently a presidential candidate for next year's election. "Indonesians do not want to taste the same bitter pill again."

"The damage done was huge," he observed during an interview. "The economy declined from a seven-percent growth rate before the IMF stepped in to a minus 13 percent growth rate. It was an economic depression on a scale we had never experienced since independence (from the Dutch in 1945)."

"Millions of people lost their jobs due to the 130 conditions covering various economic sectors that the IMF got the government to sign in order for Indonesia to get loans from the IMF," Rizal added. "It also recommended the closing of 16 banks without sufficient local preparation. That undermined the banking sector as people withdrew money from other banks and sent it abroad or kept it at home. There was a capital outflow of five billion U.S. dollars."

Similar sentiments were echoed by the 'Jakarta Post', an English-language daily, in a commentary last year to mark a decade since the Asian financial crisis. The IMF's multi-billion dollar rescue package, "with excessive policies," exacerbated the problem, the paper argued. "In Indonesia, the number of poor people jumped from 34 million in 1996 to almost 50 million in 1998."

But the country's economic landscape is much more healthy now, giving it the confidence to be selective about who it wants to roll out the welcome mat for taking outside funds to endure the current global financial crisis. Indonesia's foreign exchange reserves, for instance, are now at an impressive 51 billion dollars, far higher than it was during the '97 crisis.

"The economy is not as vulnerable today as it was during the last crisis. And the attitude towards the IMF is a sign of confidence," says Satish Mishra, managing director of the consulting firm Strategic Asia.

"Indonesia has gone through a systemic change over the past decade. The reforms in the judicial, political and financial sectors have been a phenomenal achievement."

The only worry is in the export sector, he told IPS. "Export prices have come down and that will have an impact. But it is not dependent on U.S. demand because the trade pattern has shifted towards Asian markets." The country's major exporting partners are Japan, the U.S., Singapore, China, South Korea and Malaysia. Exports in 2007 were estimated to have reached 118 billion dollars.

Indonesia's economic recovery since the '97 crash also saw it rush to get the IMF off its back ahead of schedule. In 2004, it paid up the debts it owed the Washington-based international financial institution, which was five years ahead of schedule. Indonesia, in fact, was one of the Fund's four major borrowers in 2004. The other three were Turkey, Brazil and Argentina, of which only Turkey remains a client.

Such early payments to the IMF, and an emerging view in Asia that there are other sources of funding to draw from, given the region's record of holding 3.5 trillion dollars in foreign reserves, have chipped away at the Fund's relevance in international finance.

Indonesia has warmed to seeking foreign funds through bilateral or regional initiatives than going, cap in hand, to the Fund. The Chiang Mai Initiative is one, which enables countries in South-east Asia to benefit from a network where bilateral financial swaps are possible.

"Indonesia and other countries are smart to reject the IMF's offers at this point. The G-20 meeting confirmed that, since the leaders didn't place the IMF as a significant institution at the centre," says Walden Bello, senior analyst at Focus on the Global South, a regional think tank. "They have more choices now like the money China can offer or Asian foreign exchange reserves." ☑

SRI LANKA'S OIL FUTURES GAMBLE BURNS 300 MILLION DOLLAR HOLE

Feizal Samath

The Sri Lankan government is grappling with a costly 300 million dollar payout to Citibank and Standard Chartered Bank (SCB), following a disastrous oil futures contract between the banks and the state-owned Ceylon Petroleum Corporation (CPC).

Sri Lanka's foreign reserves -- worth around 2.7 billion dollars or the equivalent of more than two months worth of imports -- is already under pressure from the global economic crisis.

SCB and Citibank have been accused of not properly informing the state petroleum supplier of the risks involved but vehemently deny any wrongdoing. Overseas officials from the two banks have been in Colombo over the past two weeks on 'damage control' visits.

Central Bank (CB) governor Nivard Cabraal said its guidelines in derivates trading had not been followed. Negotiations are now underway between the CPC and the banks to re-structure the contracts and reduce the burden on the fuel supplier.

Analysts recall that 15 years ago these two banks were implicated in a huge stock market scam following flagrant violation of the Reserve Bank of India guidelines on portfolio management services and ended up paying fines totalling 21 million dollars.

The Sri Lankan crisis came to the fore two weeks ago after newspaper reports hinted that the CPC may default on its October (monthly) payment to the banks due to a cash problem, and that the banks had not properly advised the CPC on the risks involved in the hedging contract.

De Mel then called a press conference where, flanked by the CEOs of the two banks, denied claims that the CPC planned to default while also saying the corporation was made fully aware of the risks by the banks.

After the SCB and Citibank got involved in the futures contracts, three others banks also followed suit -- on a smaller scale however –- to get into oil futures contracts with the CPC.

The deals were made through a 'zero cost collar' instrument where no premium is paid by the customer and the risks shared with the banks. The CPC decision to hedge on oil as a protection against volatile oil prices came in January 2007 when there was speculation in the market that oil prices would rise to as much as 200 dollars a barrel in the coming months.

Under the zero cost collar option, whenever the price rises between 100 dollars and 135 dollars per barrel, the banks pay an agreed amount (upto a maximum of 1.5 million dollars a month) to the CPC. Any fall in prices below 100 dollars (without any restriction unlike on the topside) means the CPC pays the banks.

Since January the CPC gained 24 million dollars (payment from the two banks) but lost 38.5 million dollars -- paid out just in two months -- and is set to pay another 300 million dollars (if the oil prices remain in the 50-60 dollar per barrel range) or more if it falls further. De Mel admitted that payment at current prices would be over 300 million dollars.

On Nov. 21, the benchmark Brent world crude price fell to 46.47 dollars per barrel, a stunning drop of almost 100 dollars per barrel from 143.33 dollars on Jul. 11 this year.

According to international news agency reports, crude oil prices are poised to fall by another 15 percent in the next week while recording its lowest price since May 2005. Even though OPEC is cutting down production to stem the sharp price fall, demand growth has fallen to its lowest in 23 years due to the world economic crisis, international market analysts say.

Someone should be accountable

Dayasiri Jayasekera, Opposition legislator and member of the Parliamentary Committee on Public Enterprises (COPE), described the issue as serious. "Someone must be accountable for this huge loss to the country. We will be fully questioning Asantha de Mel (chief of CPC) on Nov. 20 (at a COPE meeting) to get to the bottom of this," he told IPS.

Newspapers and analysts have clearly indicated that the CPC went for the wrong hedging (futures) option where the payment on the downside (borne by the CPC) was unlimited while on the topside (liability for banks) was restricted and accuse the banks of selling the wrong option and not advising the CPC of the risks.

Upul Arunajith, a derivatives specialist based in Canada, said in an e-mail interview that if the wrong instrument is used, the hedge will sooner or later go in the wrong direction and will lead into a crisis. "This is what happened in this case."

Arunajith, a Sri Lankan who initially made a proposal to the Sri Lankan government at the end of 2002 to introduce hedging, said that there were warning signals that the zero cost dollar instrument was the wrong strategy. "I had personally informed them of the impending disaster," he said. "Neither SCB nor Citibank are specialised energy traders nor do they have the wherewithal to provide a hedge to the CPC for a huge exposure of two billion dollars." *(Continued on page 6)*

UGANDA'S DEBT CRISIS COULD RESURFACE – SAY EXPERTS

Elias Biryabarema

When Uganda, alongside 18 other poverty-stricken nations, had its foreign debts cancelled and the nation ushered into a near debt-free era, the mood turned effusively joyous but critics warned that the relief would be disappointingly fleeting before the same nations ensnared themselves in waves of fresh debt.

And now those critics appear to have been breathtakingly prescient. The Bank of Uganda reported to parliament's Finance committee on November 11 that Uganda's external debt had grown by a perplexing 30 percent in the last one year alone.

Stunned MPs subsequently warned the government to urgently adopt a "new external debt (management) strategy" and "stop borrowing unnecessarily as if there's no tomorrow," according to story published in *Daily Monitor* on November 12.

On the eve of the debt cancellation by the G8, in July 2005, when Uganda's international indebtedness had reached crisis proportions, the nation owed a crippling 4.7 billion U.S. dollar and was using up to 40 percent of its annual fiscal resources to meet its debt repayment obligations.

The cancellation wiped off a whopping 3.8 billion off that mountain and the Minister of Finance, Dr Ezra Suruma, elatedly talked about the enormous amounts of resources that the country would save and instead funnel into critical sectors like education and health.

Debt cancellation opponents had cautioned that such an action would create a frustrating moral hazard: beneficiary countries would find it rewarding to borrow and accumulate debt because there was a strong hope it would be forgiven after all.

Now, the rate at which Uganda is snapping up fresh debt seems to validate this argument. Deputy Secretary to Treasury, Keith Muhakanizi, sees the disquiet over Uganda's external debt as unwanted. "All our loans are from multilateral lenders and they are concessionary, with a very low interest rate and long repayment periods." According to him the seemingly favourable conditions of these debts makes them manageable. However, most of the loans that accumulated to produce the crushing crisis before the G8 magnanimity reversed it were made under the same terms, and there's nothing to suggest that the same wont happen with the current loans.

A researcher at Makerere University's Economic Policy Research Centre, Lawrence Bategeka thinks the rapid borrowing is problematic but that of greater concern should be the use to which the borrowed funds are put. Unfortunately, even by that yardstick, Uganda's debt would seem even more worrisome, he said.

For instance most of Uganda's loans are poured into social development sectors: health and education rather than economic productivity areas like agriculture and high-profile infrastructures. "Well, health and education have returns no doubt. But their returns are indirect and not immediate and so when you spend so much of borrowed money on them you can certainly expect to have a debt crisis soon because you're not growing the nation's capacity to repay the loans," he said.

Waste and corruption

Also, the cost of poor choice in spending loan money is compounded by waste and corruption. Large portions of loans contracted for specific projects instead ends up in peripherals like office furniture, vehicles, fuel and consultancy instead of financing mainstream work.

Although he thinks Uganda hasn't slipped into another debt crisis yet, there are unsettling signs that it could in the near future. "You talk of a crisis when the debt becomes unsustainable i.e. when the country becomes unable to pay and Uganda isn't there yet," he said.

Even then there's widespread trepidation. In March 2007, Uganda's external debt stood at 1.1 billion dollar. A year later it grew to 1.9 billion dollar, just shy of half of what it was in 2005 before the cancellation. One notorious habit that nurtured Uganda's debt crisis was running wildly huge budget deficits, a habit that analysts think has in fact grown worse not better.

Although President Museveni often rails against donors and boasts of Uganda's capability to sail on its own, most analysts still think the country is still far from weaning itself off external support in form of loans principally because the government is addicted to extravagance. Courtesy Daily Monitor ☑

CRISIS THREATENS CONGO'S TIMBER JOBS

Guy-Blaise Bakala, a timber worker in Pointe-Noire in the south of the Republic of Congo, has been sleeping badly since his bosses first announced they would have to let some workers go because the financial crisis is hitting the key timber sector.

"Every single day, our bosses tell us that we are not sheltered from unemployment because of what the company is going through," said the 39-year-old, who is married with four children. Bakala fears what will happen if he loses his job.

"We would simply become homeless. We wouldn't have enough to pay for a new house," he said, adding that all four of his children go to a fee-paying school. "If I lose my job, the children will no longer be able to go to school."

The forestry sector is Congo's second-biggest earner of foreign currency after oil, which accounts for about 75 percent. At least 10,000 jobs have been created over the past decade in the timber sector, according to government figures.

The sector is the second-biggest employer after the civil service in a country where about 30 percent of the working population is unemployed, according to official data.

But now, because of the global financial crisis, wood producers are finding it harder to find markets for their goods and are cutting prices.

"There's no market, there's no demand," said Jean-Marie Mevellec, head of Congolaise Industrielle du Bois, one of the main timber companies in the northern Sangha region.

Mevellec emphasised the importance of forestry in keeping local towns alive. "Today there are towns and villages that owe their survival to the presence of a timber company that pays taxes and keeps the local administration going," he said.

"The situation of the forestry sector is aggravated by the level of the dollar and by the rise in the price of oil," said Henri Djombo, the Forestry and Environment Minister. He hoped the timber companies would keep their workers, despite the crisis.

"They should not make redundancies just for the sake of it. Because when the situation gets back to normal, they might no longer be able to find qualified workers," he said.

"We are in a situation where we can no longer pay the timber taxes and all the other duties," said Martial Fouty, head of Société Forestière Industrielles de Bois timber company.

The companies say that if the crisis continues, several thousand workers will be affected by job cuts or loss of pay. ☑

SRI LANKA'S OIL FUTURES GAMBLE . . .

(continued from page 4)

At de Mel's press conference Citibank chief Dennis Hussey said the Sri Lankan government started the hedging process following a special cabinet approval, which has been carefully documented.

SCB's Sri Lanka chief Clive Haswell said the bank had received a written undertaking from the CPC that the latter was aware of the risks.

But CPC's board of directors said no such undertaking was given and are blaming de Mel, a political appointee and associate of President Mahinda Rajapaksa and Petroleum Resources Minister Mohamed Fowzie, for taking decisions without full board authority.

Issues of impropriety are also surfacing with claims that some CPC officials got 'favours' from the banks. Attorney General Priyadas Dep told The Sunday Times newspaper that his department -- which normally scrutinises state contracts to check its legality -- was not consulted.

As pressure mounted on the government, Rajapakse summoned de Mel for a meeting. A Parliamentary committee had also summoned de Mel for a hearing but the latter did not turn up, requesting time for proper preparation.

Political observers say while de Mel and the finance minister must take the rap for undertaking to use a hedging option where the downside risks were greater, the powerful CPC chairman's political connections will come to his rescue.

This was clearly seen when CB officials, who had initially threatened to rap the banks for not following guidelines, seemed to relent later under pressure and are now guiding a re-negotiation of the payments.

As demands are being heard from some sections of the government to default payment on the basis that the banks misled the CPC, pressure has been mounting to pay up or face international repercussions.

Market analysts said that the two main foreign banks have hedged these instruments with the New York Mercantile Exchange (NYMEX).

"Any default to the NYMEX by the banks will be perceived as default of a sovereign debt which will be disastrous to the country's international rating and jeopardise Sri Lanka's standing internationally to seek foreign commercial loans," one analyst said.

The government has resorted to large scale borrowings in the international market over the past two years to fund state spending, including for costly war against separatist Tamil rebels in the island nation's north. ☑