Introduction: The Implications of the Global Economic Crisis for LDCs

A. Introduction

The current economic crisis is the result of weaknesses in the neoliberal thinking that has shaped global economic policies in the last three decades; weaknesses that have been magnified by policy failures and lax regulation in the advanced countries. The cost in terms of the bailouts and recapitalization of banks has already reached unprecedented levels. However, the adverse impact on the real economy and the cost in terms of lost output and employment are now the great concerns. Most advanced economies are in recession and emerging markets have slowed. But the major victims of this contagion are likely to be the least developed countries (LDCs), many of which are still suffering the adverse impact of recent energy and food crises (UNCTAD, 2008a) and have the least capacity to cope with yet another major external shock.

Most advanced economies are in recession and emerging markets have slowed. But the major victims of the current economic crisis are likely to be the LDCs.

The current crisis is already undercutting those factors that enabled the strong growth performances of LDCs as a group between 2002 and 2007. Their exposure is not just a reflection of traditional commodity dependence and related sensitivity to price fluctuations; it is rather the combined threat from price reversals, the slowdown in global demand and the contraction in financial flows. As a result, manufactures and service exporters (mostly Asian and island LDCs) are likely to be hit hard but less so than the commodity-dependent economies (mostly African LDCs). The LDCs are unlikely to weather the crisis without considerable additional international assistance in the short run and support for alternative development strategies in the longer run. Changes on both fronts will be needed to induce a steadier and more resilient development trajectory.

B. The likely impact of the global economic crisis on LDCs

UNCTAD expects world trade to contract by 7–8 per cent, which will be the first decline in world trade since the early 1980s, and probably the largest in 80 years.

1. Global prospects

Forecasts for the global economy in 2009 are bleak. The current financial crisis has already pushed most developed countries into a recession that is likely to have negative consequences for LDCs' future economic prospects. Global gross domestic product (GDP) in 2009 is now expected to fall and, largely as a result, UNCTAD expects world trade to contract by 7–8 per cent. This will be the first decline in world trade since the early 1980s, and probably the largest in 80 years. Given the fall of imports in the advanced economies and in the emerging and developing economies as a group, there is likely to be a major reduction in the

export earnings of LDCs. The global credit crunch will exacerbate those difficulties by reducing the availability of trade finance. The global slowdown will also hit the relatively more resilient manufacturing economies, as their productive and export capacities are mostly limited to low-skilled manufactures, while service exporters, particularly those dependent on tourism, will also suffer from the contraction in developed country spending. Forecasts for the global economy in 2009 were still being lowered when this Report was being prepared, increasing the likelihood of a major downturn and negative per capita growth for the LDCs as a whole.

Most LDCs remain particularly vulnerable to current-account shocks triggered by the global growth slowdown, owing to their weak product diversification and their high dependence on external resources to finance their development.

The impressive aggregate growth performance of the LDCs in the last decade hid significant differences in the growth of individual countries and in the extent of their dependence on external factors. Still, most LDCs remain particularly vulnerable to current-account shocks triggered by the global growth slowdown, owing to their weak product diversification and their high dependence on external resources to finance their development.

2. External vulnerabilities of LDCs

Although not deeply integrated into the world financial system, LDCs are sensitive to changes in capital flows and exchange rate fluctuations, and most are currently experiencing a major trade shock. The present weakness of commodity prices and the contraction of global demand are the key channels of transmission of the current crisis from the developed and fast-industrializing economies (China and India) to the LDCs.

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Many LDCs are experiencing sharp falls in export revenue owing to declining commodity prices and weak demand for manufactures exports. Volatile prices continue to exert an adverse impact on LDCs' economic prospects, particularly amongst those specializing in commodity exports. There have been sharp declines in prices of many commodities since mid-2008 (chart 1). The reliance on commodities as the main source of export and fiscal revenues, along with the strong pro-cyclicality of commodity prices, contributes to the considerable volatility of output growth in many developing countries, but especially in the LDCs. While the impact of increases in the price of fuels, non-fuel commodities and food have varied, nonetheless, for those LDCs that depend heavily on food and energy imports, the net effect is unlikely to be positive, given the relative price movements of their exports and imports.

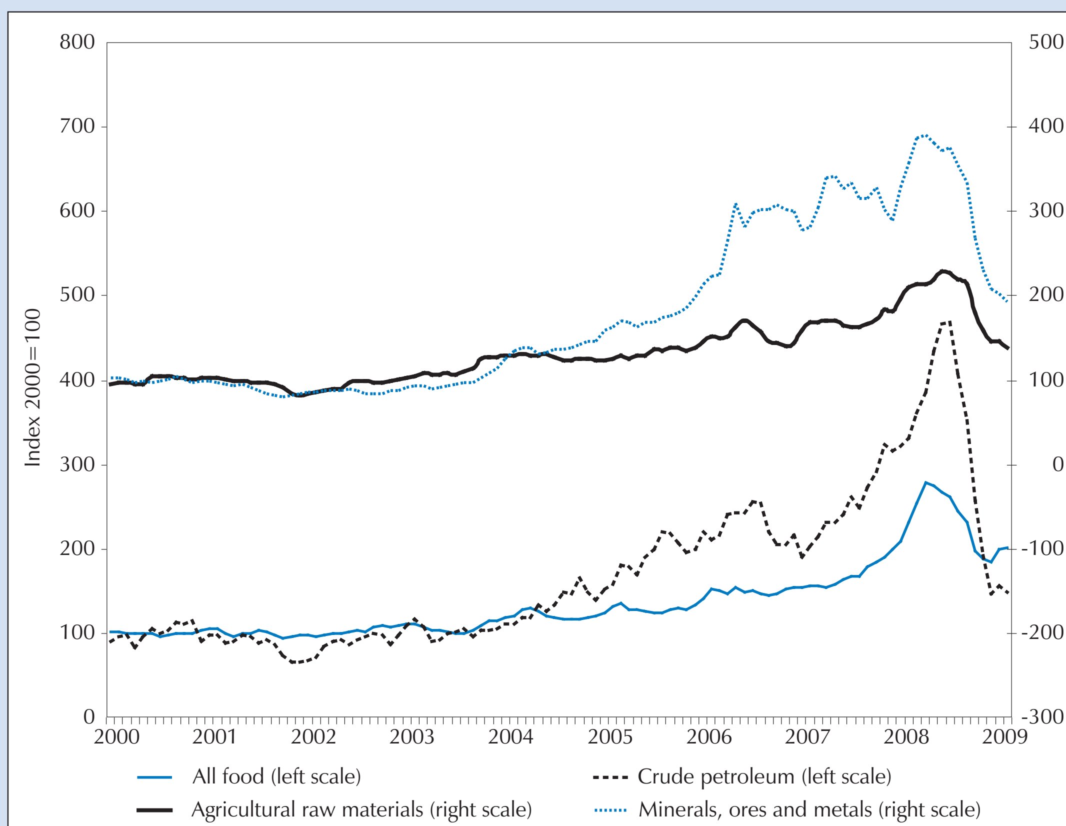
Most LDCs are prone to chronic external deficits. Chart 2 shows that only the oil exporters as a group have achieved positive, though volatile, external balances in recent years, while all the other LDC exporters have been in chronic deficit on both current and trade accounts. External imbalances are a source of vulnerability at a time of crisis, as even small reversals of capital flows can force domestic contraction, unless accompanied by extremely large improvements in the terms of trade (UNCTAD, 2008b).

The debt burden remains unsustainably high in most LDCs — an average of 42 per cent of GNI, compared to 26 per cent in other developing countries.

High levels of indebtedness represent a chronic structural weakness in LDCs. Despite an overall improvement during the recent boom, the debt burden remains unsustainably high in most LDCs, much higher than in other developing countries — an average of 42 per cent of gross national income (GNI), compared to 26 per cent in other developing countries. In about half (22) of the LDCs, the burden is between 50 per cent and 100 per cent of GNI. The growth of total external debt did not slow in LDCs as in the other developing countries, although the ratios of total debt to exports declined as the latter boomed. Debt sustainability therefore remains a critical issue for LDCs, despite the major debt write-offs under the Multilateral Debt Relief Initiative in 2006. With the expected fall in their export

Chart 1

Monthly commodity price indices, January 2000 to February 2009
(Index, 2000=100)



Source: UNCTAD secretariat calculations, based on the GlobStat database.

revenues, LDCs are likely to return in the short term to unsustainable fiscal and current account deficits.

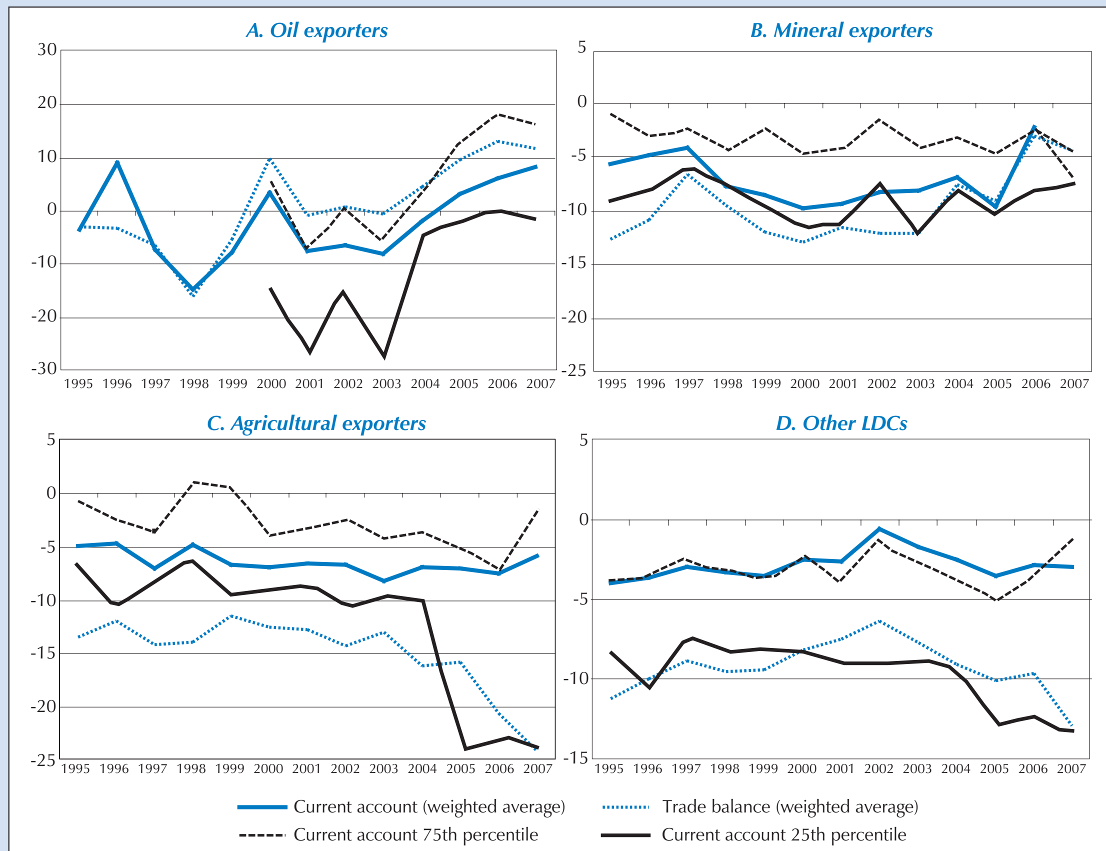
International reserves will not be enough to protect LDCs from a shortage of external finance. Reserves were increasing in LDCs as a group over the last decade, but unevenly. The accumulation of reserves as self-insurance against a balance-of-payment crisis implied diverting capital inflows from more productive uses. With reserves on average equal to between three and five months of imports in 2006 (the latest available data, chart 3), many LDCs remain highly exposed to the present crisis.

Reserves were increasing in LDCs as a group over the last decade, but this implied diverting capital inflows from more productive uses.

Many LDCs do not show a persistent pattern of overvaluation but are prone to nominal exchange rate volatility. Although not deeply integrated into the world financial system, LDCs are sensitive to changes in capital flows (UNCTAD, 2006: chap. 6) and exchange rate fluctuations. While an overvalued exchange rate can be an obstacle to industrialization in the long run, exchange rate volatility against major trading partners can add to investment uncertainty and amplify financing problems, particularly through its effects on the values of external debt, debt servicing, and the domestic value of remittances. Chart 4 (upper and lower left panels) shows the real and nominal effective exchange rates (REER and NEER) of LDCs grouped by exchange rate arrangement.[1] Chart 4, lower right panel, shows

Chart 2

External imbalances
(Percentage of GDP)



Source: UNCTAD secretariat calculations, based on the GlobStat database.
Note: Current accounts and trade balances are GDP-weighted averages for the groups. A 75th (25th) percentile is the value below (above) which 75 (25) per cent of the observations are found.

the nominal bilateral exchange rates by groups in 2008.[2] Floating currencies followed the mild dollar depreciation in the first half of the year, but resisted the strong dollar appreciation of the second half (blue line). In doing so, they depreciated vis-à-vis the dollar (black line). While appreciating with the dollar requires the use of reserves, depreciating against it can generate an adverse revaluation of external liabilities and debt servicing. Currency volatility and large gyrations of major currencies create risks and policy dilemmas even for the less financially integrated developing economies.

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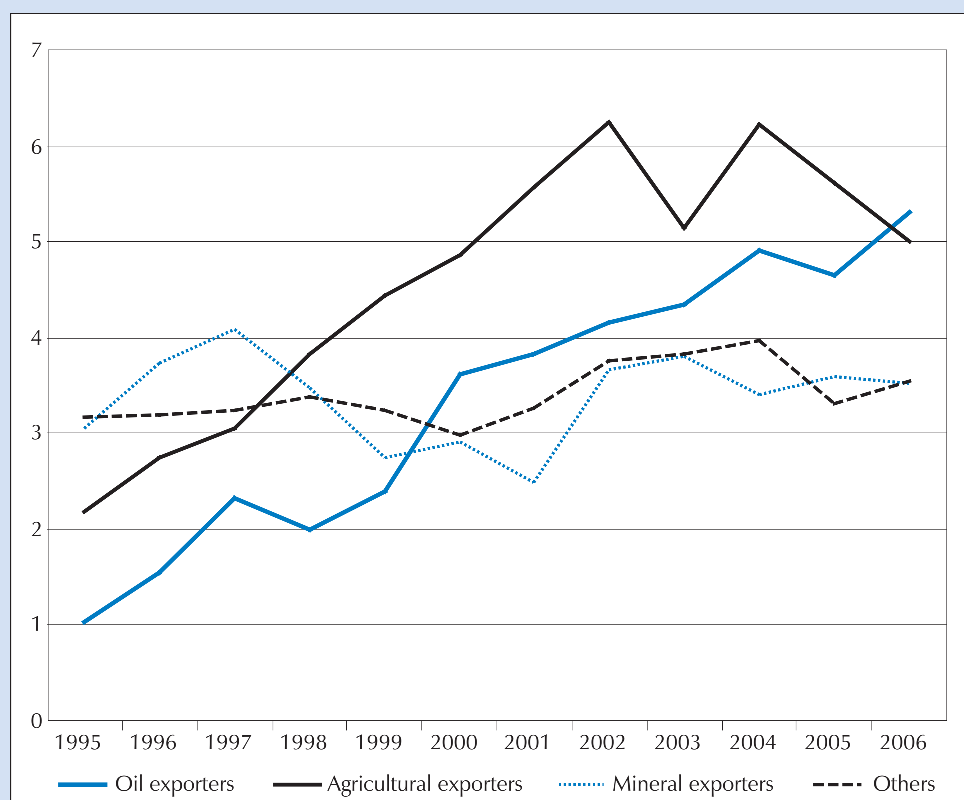
Official development assistance (ODA) levels may decline, given historical trends suggesting ODA declines following significant crises in donor countries (UNCTAD, 2008b). Despite recent pronouncements by donor countries to maintain aid levels in the face of the economic global crisis (see, for example, the G-20 statements, Washington, November 2008 and London, April 2009), there is an underlying concern that these will be difficult to respect with the shift in donors' budgetary priorities (see below).

Foreign direct investment (FDI) to LDCs is likely to decline over the next few years, owing to (a) lower expectation of profitability; (b) reduced access to credit to finance new investments; and (c) balance sheet consolidation by transnational

Chart 3

Months of imports covered by international reserves



Source: UNCTAD secretariat calculations, based on the GlobStat database.

corporations (TNCs) in the face of financial pressures. This is particularly true of FDI to LDCs that has been predominantly *natural resource-seeking* and focused on the extractive sectors, which is likely to decline during 2008 and beyond because of sharply falling mineral prices and the TNCs' cautious approach to exploration and expansion during this volatile period.

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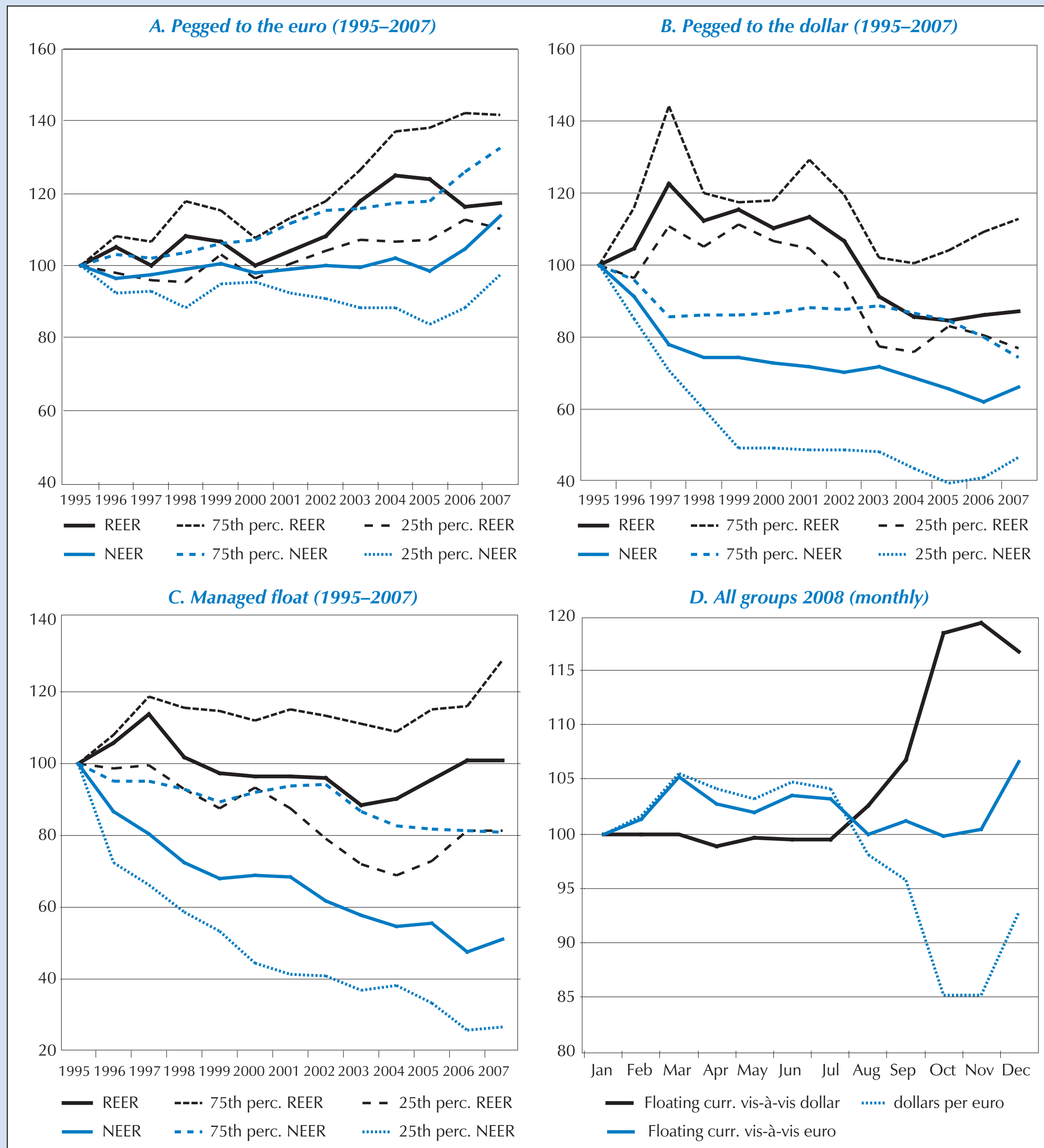
Remittances are also set to decline. Workers' remittances have become an important supplement to basic incomes in LDCs, where they generally support consumption rather than investment. According to World Bank estimates, remittances to developing countries as a whole have been increasing at a slower pace in recent years, with the annual percentage increase down from 18 per cent in 2006 to 9 per cent in 2008. They are expected to decline by between 5 per cent and 8 per cent in 2009, with a possible slight recovery in 2010.

3. The cumulative impact

Given the global economic prospects and specific vulnerabilities of LDCs, it is highly unlikely that they will be able to attain for the next few years anything like the growth rates they achieved for most of the present decade. Unlike advanced countries and some emerging economies, most LDCs are unable to support countercyclical measures or bail out their leading sectors. This is likely to undermine their achievements of the present decade in lowering poverty and

Chart 4

Exchange rates indices by groups of LDCs



Source: UNCTAD secretariat calculations, based on the GlobStat database.
Note: REER and NEER are the median of the real and nominal effective exchange rates within the group, while a 75th (25th) percentile is the value below (above) which 75 (25) per cent of the observations are found.

improving social welfare. Even before the marked deterioration in global economic prospects in the second half of 2008, it was becoming clear that there was little chance that most LDCs would be able to meet the Millennium Development Goal (MDG) of halving poverty between 1990 and 2015; for the majority, most of the other MDGs still appear to be beyond reach. The human and social costs of the present crisis are considerable everywhere, but for the poorest countries, they will include not just the loss of employment but also rising levels of poverty, spreading malnutrition and higher mortality rates for children and other vulnerable groups.

There will also be increased pressure on the skilled and able-bodied to emigrate. For many LDCs, there is thus a real risk that this economic crisis will turn into a social and humanitarian disaster.

The immediate challenge facing the LDCs is now twofold: (a) to check and, if possible, offset the fall in domestic demand in their economies; and (b) at the same time, to maintain and, if possible, increase their efforts to diversify their economies and lay the basis for a more secure path for growth and development. In particular, a crucial objective for most LDCs is to make agriculture significantly more productive in order to achieve greater security of food supplies and to provide the basis for the development of a more diversified range of productive capacities. In the present circumstances, the LDCs will be unable to meet this challenge without substantial and speedy help from the advanced economies.

A crucial objective for most LDCs is to make agriculture significantly more productive in order to achieve greater food security and allow for the development of a more diversified range of productive capacities.

In a recent study of the implications of the global financial crisis on low-income economies, the International Monetary Fund (IMF) has reached similar conclusions (IMF, 2009). The critical questions are where and how the LDCs will find the resources to revive investment, increase social spending and lower poverty levels, and how they will begin to adapt to the threats from climate change. These are major questions for both domestic policymakers and the international community.

What will actually happen in LDCs over the next few years will critically depend on ODA trends. It is imperative that ODA not be reduced, particularly under present conditions. ODA can play an important role in long-run development by facilitating both social spending and productive capacity-building, but the composition and volatility of ODA continues to work against such goals. UNCTAD research has highlighted the need for its more effective use in supporting capital formation, for example, in smallholder agriculture, as well as for reducing its volatility (UNCTAD, 2000; 2006). In a similar vein, the United Nations Commission of Experts on Reforms of the International Monetary and Financial System (United Nations, New York, 6 January 2008) called for the advanced countries to increase aid by up to 20 per cent, including for infrastructure and long-term development and environmental projects. Long-term policies and measures are needed to diversify exports, enhance domestic resource mobilization, and build domestic financial sectors as well as domestic productive capacities. Building new institutions and improving the functioning of financial markets and institutions in order to provide credit to productive enterprises will also help to build resilience to external shocks.

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C. Alternative development strategies for LDCs

The current economic crisis creates both the necessity and the opportunity for a change of direction by LDCs and their development partners. The LDCs, although in a vulnerable position, must start to address their chronic structural weaknesses. In this context, this Report recommends:

- Refocusing attention on developing productive capacities;
- Building a new developmental State based on a better balance between States and markets; and
- Ensuring effective multilateral support.

1. Refocusing attention on developing productive capacities

Thirty-eight LDCs are currently producing PRSPs, which continue to focus on liberalization, attracting external resources and increasing social sector spending.

Thirty-eight LDCs are currently producing poverty reduction strategy papers (PRSPs). As shown in past *Least Developed Countries Reports*, these policy documents continue to focus on liberalization, attracting external resources and increasing social sector spending. In general, domestically-generated resources have either failed to be mobilized or have been inadequate to support significant investments in new productive capacities. The hope that FDI would play a major role in diversifying LDC economies has not been fulfilled. FDI is invariably a lagging — not a leading — variable in the development process. What FDI has flowed to the LDCs in Africa has been largely concentrated in resource-based activities with weak linkages to the rest of the economy (in Asia, foreign investment was more involved in the manufacturing industry). ODA, consequently, has been the major source of external finance, but for some years it has been largely focused on improving social services and "governance", rather than the expansion of productive capacities. The needs of the LDCs for ODA, both for development and current-account financing, will not diminish in the current crisis; instead, they are likely to increase considerably.

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Policies need to refocus on developing productive capacities. This idea has been set out in detail in earlier *Least Developed Countries Reports,* particularly UNCTAD (2006). However, it is now more pertinent than ever. Developing productive capacities implies that increased attention needs to be given to mobilizing domestic resources, accelerating the pace of capital formation (both public and private) and promoting technological learning and innovation. Policies should also seek to establish strong backward and forward linkages within and across sectors, and to promote structural change.

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2. Building a new developmental State

Promoting the development of productive capacities will require a new balance between States and markets. However, neither the good governance institutional reforms which many LDCs are currently implementing, nor the old developmental State, including successful East Asian cases, are entirely appropriate models now. Discussion on the issue of governance must move beyond unhelpful and false dichotomies. Governments do not face a stark choice of good versus evil, the "vice" of State dirigisme versus the "virtue" of markets, privatization and deregulation. The institutions of the "State" and the "market" have always coexisted organically in all market-based economies; hence, the "choice" between the market and the State is a false dichotomy. This has been recognized at least since the time of Adam Smith, although these insights have been lost in subsequent interpretations. The challenge is to design effective governance practices which interrelate States and markets in creative new ways in the service of national development within a global context.

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What is required now is a developmental State that is adapted to the challenges facing an interdependent world in the twenty-first century. The preferences and priorities of the people of LDCs can only be set by a strong representative State with a clear developmental vision. This State should seek to harness local, bottom-up problem-solving energies through stakeholder involvement and citizen participation that creates and renews the micro-foundations of democratic practice. It should also embrace a wide range of development governance modalities and mechanisms within a mixed economy model to harness private enterprise, through public action, to achieve a national development vision.

There is also a need for policy space to allow experimentation. The need for flexibility is evident in the actions of the Governments of the advanced economies in their response to the systemic crisis afflicting them. Policymakers in the advanced economies have markedly changed their ideas about the desirability of hitherto rejected policies to provide fiscal stimuli to growth, for tighter regulation of the financial sector, to nationalize failed banks, and in general to allow a much greater role for the State in controlling and guiding the national economy. Even "industrial policy", previously subsumed under various titles such as "competitiveness policy" or "defence policy", has now been brought back into the open in the United States and Western Europe (Hollinger, 2009).

A key question is whether official lending is able and willing to offset the current retreat of private sector finance from developing countries.

3. Ensuring effective multilateral support

One of the characteristics of the current global economic crisis is that speculative activities have not been confined within national boundaries and they have had a de-stabilizing influence on the global economy. The rapid descent into recession of the developed countries has led to an even more severe and rapid downturn in the exports of most developing countries. At the same time, the banking and financial crisis in the United States and Western Europe has led to a major and indiscriminate withdrawal of funds from emerging market economies, as banks and other financial institutions struggle to reconstruct their balance sheets in the wake of massive losses in the asset markets of the advanced economies and as private and other corporate investors move their funds to safer havens. This contrasts with the four decades before the First World War, when foreign capital flowed from the North to the South when the former slowed down, and thus had a stabilizing influence on the world economy.

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A key question is whether official lending is able and willing to offset the current retreat of private sector finance from developing countries. The World Bank, as a triple-A rated institution, was one of the few beneficiaries of the "flight to safety" in 2008: it raised some $19 billion in medium- to long-term bonds in fiscal 2008 at relatively favourable rates of interest. More significantly for the LDCs, donor countries pledged a record $41.7 billion in International Development Association (IDA) funding for fiscal years 2009–2011. Together with a transfer of $3.5 billion from the International Bank for Reconstruction and Development and the International Finance Corporation, this should make available some $15 billion a year for nearly 80 of the poorest countries. More recently, however, the World Bank has estimated that the developing countries face a funding gap of anywhere from $270 billion to $700 billion a year as a result of capital flows evaporating. Only about a quarter of vulnerable countries have been able to obtain some relief against the slump.

The LDC economies are mostly small and their situation is not seen as posing a serious systemic risk to the global economy. It can be feared that their needs will be treated less urgently than those of others.

Whether or not the international institutions will be able to support every country that needs help to cope with the impact of the financial crisis remains to be seen. In early 2009, much of the attention of the international financial institutions was focused on the problems of some of the Central and Eastern European economies and related fears for Western European banks. The LDC economies, however, are smaller and, because of their limited exposure to the international financial system, their situation is not seen as posing a serious systemic risk to the global economy. There are therefore grounds to fear that their needs will be treated less urgently than those of others. It is the argument of this Report that the developed market economies, which are most responsible for the global financial collapse, not only have a moral obligation to help the poorest countries through the present crisis, but they also share a mutual interest in setting the LDC economies on a sustainable growth path. Failure to do so will

risk increasing the number of unstable States and thus the wider threats to peace and security. Poverty and related social problems have already increased and the intensification of the food crisis in early 2008 quickly led to widespread riots in many of the poorest countries.

Increasing the resources available for ODA will have a limited impact in strengthening the conditions for sustained growth in the LDCs, unless there are changes in the basic approach of donors both to stabilization policy and to longer-term development strategy.

There were, however, some encouraging signs in early April 2009, when the leaders of the G-20 countries agreed to a potentially large increase in the funds available to the developing countries through the mediation of the international financial institutions. IMF resources are to be raised to $750 billion (from $250 billion)[3] and there was also support for a new issue of special drawing rights worth $250 billion, the latter carrying very low rates of interest and not subject to intrusive conditionality. The G-20 leaders also agreed to "support" an additional $100 billion by the multilateral development banks (including regional institutions such as the Asian Development Bank), and accepted an African proposal to sell part of the IMF gold reserve to finance a $50 billion rescue package for low-income countries. Another $250 billion was promised, over two years, to support the provision of international trade credit by export credit agencies, development banks, etc.

This appears to be a significant increase in funding but, as with all such declarations, it needs to be borne in mind that not all of this is new money. Much of it is promised rather than being immediately (or imminently) available, and not all of it is likely to be spent. Part of the increase in IMF resources will be held in reserve, in case the global economy deteriorates more than currently expected.

Increasing the resources available for ODA, however, whether it be done through the international financial institutions or by individual donor countries, will have a limited impact in strengthening the conditions for sustained growth in the LDCs — and in contributing to the support of global demand — unless there are changes in the basic approach of such donors, both to stabilization policy and to longer-term development strategy in developing countries. Some of the key elements of such a change have already been discussed but, although the G-20 leaders expect the IMF to take the lead role in assisting the developing countries most affected by the crisis, they did not link increased funding to radical reform of the organization, nor did they insist on substantial changes in the conditions attached to its loans. Although Prime Minister Gordon Brown of the United Kingdom declared at the G-20 meeting an end to the "Washington Consensus" triad of liberalization, privatization and deregulation, there are continued concerns with the IMF's business-as-usual approach. At least to date, there are few signs of change in IMF conditionality on its short-term lending: recent loans to Ethiopia and Ukraine, for example, were accompanied by demands for pro-cyclical and severe tightening of fiscal and monetary policies, as well as for a number of institutional reforms (IADB, 2001).

National ownership of the development agenda and a more efficient use of ODA could be achieved if the recipient countries were to set out their macroeconomic and microeconomic objectives, provide an account of how they intend to reach them, and indicate where they think ODA would be most effective.

Throughout this Report, the need for ODA is constantly underlined, but the key emphasis is on the need for the recipient countries to exercise a much greater control over the uses to which such assistance is put. The problems of aid effectiveness have been discussed for a long time, often in somewhat polemical terms. But both national leadership (or ownership) of the development agenda and a more efficient use of ODA could be achieved if the recipient countries were to draw up their own four-to-five-year programmes, setting out their macroeconomic and microeconomic objectives, providing an account of how they intend to reach them, and indicating where they think ODA would be most effective in moving the development process forward. ODA is essentially a form of government intervention to ease shortages, bottlenecks and other constraints on growth, including fiscal and current-account deficits, but it is difficult to target assistance to where it will be most effective without a clear sense of priorities

and some idea of the potential impact of removing one particular bottleneck before another. Similarly, the impact of ODA will be reduced if important complementarities and linkages are overlooked. ODA is also likely to be more productive if it is committed and delivered to match the time-frame of a multi-year national programme, although it could still be released in tranches according to intermediate stages of the programme being achieved. Some conditionality will be necessary in order to maintain political support for assistance in the advanced economies, but with a transparent programme, the recipient country can suggest its own intermediate goals instead of an international organization imposing its conditions.

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ODA could also be more effective if neighbouring countries were to prepare and implement their programmes simultaneously, with a view to developing regional infrastructure projects, for example, or increasing their intraregional trade. Infant industries may stand a better chance of survival if they can have access to their neighbours' markets as well as their own. Peer reviews of programmes and experience in a regional context can also stimulate the processes of learning, experimentation and adaptation that are inescapable requirements for successful development. Regional cooperation is itself a sign of increased political stability and that can have a positive effect on the propensity to invest. A constraint on establishing such development programmes is the shortage of relevant technical skills in a country, but this can be overcome to some extent by drawing on independent advice from abroad.[4]

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There is a critical political dimension to developmental success. A development programme is not simply a technical document: (a) it serves an important political function, insofar as it sets out the Government's vision of the economic and social transformation at which it is aiming; and (b) it effectively lays out its goals and priorities, as well as the path chosen — or thought most likely — to achieve them. It is the task of politics to build and retain popular support for the development programme, to create a framework of democratic engagement and accountability, and to persuade the population that it is for the benefit of all and not just for a privileged few. This would be a step towards providing a concrete, operational basis for such ideas as "ownership" and "partnership", which otherwise run a high risk of degenerating into empty slogans. Countries essentially develop a growth dynamic from their own culture and history, and from the internal demands of the population for change. The "developmental State" is fundamentally about the leadership required to trigger those demands for change and unite them behind a feasible programme for development. If the politics are right, many different routes can lead to success; if the politics are wrong, little or nothing will be achieved.

The fiscal stimulus by the G-20 economies must be global in outlook and in practice... it must be directed not just at the rich countries, but also at the poorest.

Rethinking development policies and improving the effectiveness of ODA will take time. Meanwhile, the LDCs are facing a major crisis and are seeking urgent assistance. How can that be organized? The place to start is the affirmation by some of the major advanced economies, including the United States and the United Kingdom, that the fiscal stimulus by the G-20 economies must be global in outlook and in practice: those who can contribute to expansion must do so; those that need help must receive it. In other words, any fiscal stimulus must be directed not just at the rich countries, but also at the poorest. One way to do this, and do it quickly, would be to transfer a proportion of the stimulus in the advanced economies directly to the LDCs in the form of grants. Grants can be delivered more rapidly than loans. It would not be helpful to increase the indebtedness of countries already burdened with debt, and there is a moral issue raised by rich countries forcing the poorest to go further into debt in order to deal with a problem created by the rich. A rapid transfer of such grants would have the objective of supporting the LDCs in their attempts to cope with the two broad challenges mentioned earlier: (a) to prevent a severe contraction of

domestic demand that would drive millions more people into poverty and hunger; and (b) to ensure that development programmes and projects already underway (for infrastructure investment, pandemic disease control, etc.) are not suddenly disrupted or abandoned because of a cut-off in the supply of finance or critical imports.

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The IMF has estimated that the poorest countries may need some $25 billion to cope with the immediate impact of the crisis on their reserves but, depending on how far the global economy deteriorates, their needs could be as high as $140 billion. The rich countries have, together, put a $5 trillion stimulus into the global economy, largely focused on saving their own banks and boosting domestic demand. If they were to divert, say, 0.7 per cent of that in grants to support demand in the poorest countries, $35 billion could be quickly transferred to the LDCs; another 1 per cent of the stimulus would take the sum to the mid-point of the IMF's estimated range. Combined with a rapid deployment of "soft" loans from the World Bank's IDA, such a programme would deliver real aid where it is most needed. The propensity of LDCs to spend such cash grants, an important requirement of the global stimulus, is likely to be very high, and much of it is likely to be spent on the output of the advanced economies.[5]

If rich countries were to divert 0.7 per cent of their stimulus packages to support the poorest countries, $35 billion could be quickly transferred to the LDCs.

By making cash grants available to the LDCs, rapidly and without restrictive conditions, the G-20 would be able to demonstrate both its commitment to an inclusive approach to dealing with the current crisis and to an open, liberal trading system. A failure of the advanced countries to respond with exceptional measures would only heighten the United Nations Secretary General's fear that this "may not only be an economic crisis, but may develop into global political instability".

For the longer term, the current crisis is an opportunity to reconsider policies and the role of institutions. This Report discusses a selection of key, longer-term policy issues, from different approaches to macroeconomic policy and governance, through the key role of agriculture as a trigger for broader development to industrial policies. The underlying theme is to revive and renew the role of the developmental State as the means of laying the basis for sustained development in the most disadvantaged countries.

D. Organization of this Report

This Report is organized in four chapters.

Finding a better balance between States and markets is not a matter of going back to old-style development planning, but rather a question of finding new forms of development governance appropriate for the twenty-first century.

Drawing mainly from existing literature, the first chapter, "Rethinking the Role of the State in LDCs: Towards Development Governance", examines how it is possible to inject a development dimension into discussions of governance. It begins by assessing the current good governance institutional reform agenda from a development perspective, and goes on to review the relevance of the idea of the developmental State for LDCs. It argues that there is a need for a new developmental State adapted to the challenges of the twenty-first century, and discusses how it may be possible to build developmental State capabilities in LDCs. Overall, it argues that finding a better balance between States and markets is not a matter of going back to old-style development planning, but rather a question of finding new forms of development governance appropriate for the twenty-first century. Such development governance would be founded on a strategic collaboration between the State and the private sector that will encourage the structural transformation of LDCs from agrarian to post-agrarian economies.

The second chapter, “Meeting the Macroeconomic Challenges”, discusses the role of macroeconomic policies in supporting domestic resource mobilization and expansion of productive capacity. It offers a sketch of an alternative macroeconomic framework for the LDCs. It evaluates the neglected role of fiscal policy in LDCs, aimed at expanding the scope of counter-cyclical policies, given the current fiscal and current-account imbalances. Moreover, the chapter revisits the role of monetary policies, the effects of targeting low inflation as well as the role of exchange rate management. The findings underscore the general need for the coordination of macroeconomic policies and need for greater use of Keynesian-style macroeconomic policies in supporting domestic resource mobilization and expansion of productive capacity.

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The third chapter, “Setting the Agenda for Agricultural Policy in LDCs”, considers the neglected role of agricultural policy in the transformation process in LDCs aimed at achieving food security and poverty reduction. Whilst agriculture is a major component of almost all LDC economies, the key policy challenge they face is how to promote agricultural growth which would enable a structural transformation towards a dynamic growth path. The chapter suggests that, to enable this transition, policy issues in agriculture need to be addressed seriously in terms of multiple intersectoral linkages which often involve complex choices. The role of the State through public investment and collaboration with other productive agents in the transformation process is emphasized.

A key policy challenge LDCs face is how to promote agricultural growth which would enable a structural transformation towards a dynamic growth path.

Chapter four, “Tailoring Industrial Policy to LDCs”, delineates a general framework for a renewed industrial policy specifically tailored toward LDCs — the Developmental Industrial Policy (DIP) — which is defined as any strategic intervention by the State that catalyses structural change and stimulates economic restructuring towards more dynamic, higher value added activities. The chapter reviews a number of alternative approaches to industrial policy, including from successful small, open economies (Nordic countries, such as Sweden and Finland, and Ireland) as well as in contemporary LDCs, along with lessons that might be drawn from their experiences, given their respective constraints and opportunities. It suggests that, while the role of the State is vital, there is no universally successful model of State–market relations or industrial policy. Consequently far greater policy space, scope for experimentation and learning is required than is currently available, to find the most appropriate path to development. This implies using the fullest flexibility of policies and measures to mitigate the adverse impact of the global economic crisis, both in the short and the long term.

Notes

1 A progressive nominal depreciation vis-à-vis the main trading partners has allowed managed floating and dollar-pegged economies to avoid overvaluation of their currencies in real terms. African CFA franc zone economies have suffered from the progressive appreciation of the euro in recent years (a nominal appreciation vis-à-vis other trading partners), as well as from a real appreciation induced by inflation differentials.
2 The United States dollar/euro exchange rate index (light blue line) shows the mild depreciation of the dollar against the euro in the first half of 2008, its large appreciation between June and October and its partial reversal in December. It therefore shows the appreciation of the dollar–pegged currencies relative to the euro and the depreciation of euro-pegged currencies to the dollar.
3 The increase of $500 billion is to come from member countries making loans to the organization. This arrangement was criticized during the United Nations General Assembly's dialogue on the global economic crisis (25–27 March 2009) for potentially weakening the IMF's surveillance role by making it reluctant to censure the policies of countries from which it had borrowed funds.
4 These suggestions for improving the effectiveness of ODA draw on the operating principles that guided the Marshall Plan in Western Europe after the Second World War, but which appear to have been largely forgotten when it came to assisting developing countries. For a more detailed discussion, see Kozul-Wright and Rayment (2007).
5 In addition to these grants, the advanced economies will also need to ensure that the developing countries have access to ample liquidity in 2009 and 2010, as estimates of their need to roll over debt due in these years are relatively high. The G-20's decision to increase the resources of the IMF should ease the process, at least if implementation is rapid and if conditionality is not restrictive.

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