XXII Technical Group Meeting of the G24

March 16-17, 2006

Palais des Nations, Geneva

Summary of Presentations and discussion[1]

The XXII Technical Group Meeting of the G24 was held under the chairmanship of Mr. Roberto Tan, Deputy Finance Minister of The Philippines. The Secretary General of UNCTAD Mr Supachai Panitchpakdi opened the meeting with welcoming remarks.

I. Mr. Vito Tanzi presented the first paper on "Global Imbalances and Fund Surveillance". After providing a general background with regard to the creation of the IMF, including the role played by US influence, Mr. Tanzi focused on the effectiveness of the surveillance function of the IMF. Following the presentation of the general background to global imbalances, the author asked:

- How can the Fund pressure surplus countries to adjust the exchange rate of their currencies?
- And would these adjustments suffice to reduce the deficits of the deficit countries?
- Or should the Fund pressure the deficit countries to reduce their fiscal deficits and to increase their interest rates?

Mr. Tanzi then goes on to elaborate on the requirements for more effective Fund surveillance, including requirements of technical and others of a political nature. As regards technical requirements, Mr Tanzi argued that the Fund does not have enough first class staff to discharge its various mandates, and that very often (as in the case of the composition of foreign exchange reserves) it does not have access to the detailed information required for proper analysis. As regards political constraints, Mr Tanzi raised questions about the legitimacy, political independence, and willingness of the Board and of Fund management to make strong, politically sensitive judgments about the policies of powerful countries and the needed changes in these policies. According to Mr. Tanzi, a more representative Board would have more legitimacy, but not necessarily more power to convince members.
To conclude Mr. Tanzi listed some possible reforms:

- First, it would be desirable to apply more faithfully the formula that allocates quotas and voting power in order to remove anomalies,

[1] All of the papers presented and the biographies of the presenters are given on the G24 website: www.g24.org.

although he acknowledges that such a process might not prove feasible.

- Second, he would to add some “fresh blood” to the group of individuals who work on issues related to global imbalances, including some renowned scholars (“super stars”).
- Third, he claims that the managing director and the staff should be given clear signals that honesty and even bluntness is encouraged in this area. Too many qualifiers and too much diplomacy often reduce the impact of necessary messages.
- Fourth, following Mervyn King, Mr. Tanzi argues that much more attention should be directed at national balance sheets: (a) to get a full picture of financial claims that countries have against other countries; (b) to acquire a sense about the potential speed of any likely adjustment, say in the United States or in China; (c) to have a sense of the impact of relative prices changes on the value of assets and liabilities.
- Finally, Mr. Tanzi pointed out that the Fund’s total resources have become totally inadequate to cope with potential macro disequilibria; in fact that inadequacy may be one of the incentives for accumulating reserves on the part of some countries.

M. Torres referred to Mr. Tanzi’s comment on the tension between multilateral surveillance and Fund’s attention to poor countries, suggesting that stronger multilateral surveillance and less attention by IMF to low income countries could bring about promising results. Mr. Torres also noted that coordinated action (e.g. on exchange rates) must start somewhere, and that a strong protectionist sentiment in US, which currently affects developing countries, stands in the way of a solution. On the question of more legitimacy and more power, Mr. Torres points out that legitimacy is about credibility; that without credibility, there is no possibility of legitimate messages. As regards the hiring of renowned scholars, (referred to as “super stars” in Tanzi’s presentation), Mr. Torres points out that renowned scholars also have interests of their own.

The representative of Egypt recalled that the first East Asian country that rejected IMF advice came out of the crisis first (Malaysia), and that the IMF is too proud and its advice sometimes worsens the crisis. He asked for more humility from the Fund. As to the Board’s political independence, he argued that since EDs represent members, the Board was never politically independent. Hence, discussing the Board’s political independence is a non-issue.

The representative of Nigeria stressed the need for Fund staff to be blunter in their assessments. The Fund staff had no sense of specific reforms required. Small countries had little influence while large countries’ influence is excessive.

The representative of India asked if solving the fiscal problems in the US would solve global imbalances.

Mr. Tanzi responded that there has been very little multilateral surveillance. Whether this is this good or bad for less developed countries is not clear. There is certainly need for coordination. But how can the IMF bring about this coordinated action? What can the Fund do to change protectionism in the US, or US fiscal policy? He agrees about the need for more humility. As per the Board's political independence, Mr. Tanzi believes King's proposal would make Board more dependent. Finally, as regards the possibility of solving global imbalances by reducing fiscal deficits in the US, Mr. Tanzi states that we are currently undergoing a market based solution, but which could bring about serious problems. In the 1980s adjustment was gradual, market based and it worked. The US fiscal deficit is posing a problem right now; reducing it would certainly help.

II. Richard Webb presented a paper titled "Beyond the IMF", which he coauthored with Devesh Kapur. The authors' purpose was to examine the governmental and market mechanisms that have developed in the world financial community as ways to complement and fill the gap created by IMF deficiencies. The authors' review had two objectives in mind:

- The first amounted to a stock-taking: an assessment of what defenses, in addition to a weakened IMF, are in place to prevent and to deal with financial turbulence.
- The second objective is more pro-active; the discovery of non-IMF, defenses against financial instability, measures and policies that could reduce the risk and costs of instability, independent of IMF shortcomings or reform.

The presentation reviewed the core IMF functions - crisis resolution, exchange rate management, financial policy coordination and surveillance - and found examples of non-IMF organizational arrangements in all cases. However, the authors focused in particular on the insurance role of the Fund and argued that developing countries are developing alternative insurance mechanisms, from a high level of reserves to regional co-insurance facilities, to remittances as a counter-cyclical source of foreign exchange. The de facto exit of its clientele, driven by the combination of high political costs associated with Fund borrowing and growing availability of alternatives, now poses an unprecedented challenge for the Fund, and in particular puts pressures on its income. Given the close link between this exodus and the high costs of borrowing from the Fund linked to its high administrative costs, the authors also examined the options available to the Fund if it is to reverse its loss of clientele. In particular, in addition to governance reform, the Fund's future seems to require significant cuts in its administrative costs, using budget savings to lower borrower interest rates.

The presentation concluded with an assessment of the systemic implications – instability and possible deflationary bias – of a continuing non-reformed IMF accompanied by a continuing move towards non-IMF arrangements. The authors conclude that when thinking about the management of world financial system we ought to move in the direction in which other organizations have moved (e.g. TNCs went from vertical organization to virtual networks; or as in modern governments, which consist of a constellation of independent government units and non-governmental influence). The transformation in the nature of governance may help influence the management of world finance.

Mr. Torres contemplated the experience of Argentina, mentioned in the presentation. He agreed in that Argentina's experience entailed a big change, in that there was no bail out. But according to Mr. Torres, while the Fund provided no finance to bail out private creditors after default, it could be argued that it had already done so in 2001, at least for well informed creditors.

Mr. Buira asked if Mr. Webb welcomed the new trends described, which depict a world where multilateral institutions play a minor role and countries resort to self-insurance, and stated that this mechanism is unnecessarily costly. He noted that we are currently benefiting from a growing world economy, low interest rates and spreads, high commodity prices, and so forth. In this favorable environment one could survive without these institutions; but as the business cycle has not been abolished and when the slowdown comes the world may need these institutions to deal with difficult times.

The representative from the Philippines stated that he could see the Fund becoming irrelevant in the future, unless major reforms are made. In his view, the world economy needs to be managed; e.g. in 1997 Asians gathered together because IMF was not moving fast enough. That's why there were discussions of an Asian monetary Fund, shot down by EU and US. There has to be a global institution to manage the world economy. To conclude he asked whether in this context one should close the IMF and create a new institution.

Mr. Webb agreed in that it seems the world economy needs someone to be in control, and that might be the IMF's role; although such a result will not take place with the current governance structure; there is need of greater legitimacy. According to the presenting author, reforming the IMF means creating a Fund that has not existed; there was never a Fund that could solve problems in the expected way; what we had was the US trying to manage world finance. We should create a different Fund, not reform the Fund.

III. Ariel Buira and Martin Abeles presented a paper on **"**The IMF and the Adjustment of Global Imbalances". The authors discussed the trends of recent global imbalances and the financial flows that sustain them, as well as the risks they pose with regard to international financial stability and worldwide economic

growth. They discuss the responsibilities of IMF's surveillance in their correction under Article IV of the Articles of Agreement.

The paper analyzes the likely impact of a potential dollar crisis on developing countries through a reduction of capital flows, increased interest rates, higher spreads on debt service and on their access to borrowing. The impact of a crisis on their export revenues is also considered. In this connection, the paper assesses the Fund's likely response to a dollar crisis, and considers what could be the Fund's most constructive response, consistent with its purposes.

The authors discuss the Fund's potential role in dealing with global imbalances in the light of the Articles and of the Fund's own history, particularly the precedent set by the Oil Facility of the mid-1970s. The paper proposes the establishment of a counter cyclical facility to deal with exogenous shocks to assist developing and emerging countries.

In order to reduce the risks and the deflationary impact on the international economy of a reduction is US aggregate demand, the paper proposes a coordinated approach to the management of the global economy by the 20 largest economies. In order to re-balance world demand and the correct global imbalances; exchange rate and fiscal policy adjustments should be undertaken with the Fund's technical support.

Lauren Phillips asked about the sufficiency of Fund resources to fund an exogenous shocks facility. Mr. Torres expressed his concern about exchange rate re-alignment not being sufficient and the need to also correct budget deficits in the US. What was the ECB expected to do in this case?

As regard availability of resources, Mr. Buira mentioned that the Fund had borrowed funds from surplus countries for the Oil Facility of 1974-75, reviewed in the paper; this was a precedent that could be followed for raising additional resources.

As to the need to correct the US budget deficit, Mr. Buira pointed out this should be an important part of the process of rebalancing global demand from deficit to surplus countries. In the absence of fiscal adjustment the US would continue to run a large current account imbalance.

Demand rebalancing was required as without it, a fiscal adjustment in the US would bring about a global recession. Hence the need for a G20 Plaza-type accord where exchange rates are realigned and the deliberate shift of global aggregate demand coordinated.

Exchange rate realignment was not required for the Euro, but only for surplus countries with pegged currencies. This posed a collective action problem, particularly in Asia; where several surplus countries with pegged exchange rates had to move simultaneously to avoid losing market share to their competitors.

IV. Nancy Birdsall presented a paper on "A Stability and Social Investment Facility for High-Debt Countries", which she coauthored with Kemal Derviş.

The paper seeks to provide solutions to overcome the inequality bias resulting from high debt in many developing countries.
As posited by the authors, a number of high-debt emerging-market economies face structural, long-term debt problems that tend to keep their growth rates low, that severely constrain social spending and human development, and that make them vulnerable to capital flow reversals that impart an un-equalizing bias to the growth process. Unless the nature and pace of growth can be improved in these lower-middle income countries, the Millennium Development Goals (MDGs) are unlikely to be met both in many of these countries or globally. These high-debt emerging-market economies face an impossible choice between draconian, never-ending fiscal austerity, or a financial crisis and a “debt event.” Both of these “bitter pills" impose high social and economic costs.

To deal with this issue, the authors propose the creation of a “Stability and Social Investment Facility” (SSF) to be housed either at the IMF or the World Bank. It would be a long-term facility to help high-debt emerging market countries cope with and ultimately overcome a chronic structural weakness. The SSF would be an instrument providing a steady and predictable source of long-term funds as well as a strong policy signal to help high-debt emerging-market economies reduce their debt burden without having to forgo vital pro-poor social expenditures and growth programs. For the facility to have a significant impact on debt and income dynamics in the eligible countries, they estimate it would need to lend $10-20 billion a year. The financial cost to the donor community would be the interest subsidy built into the SSF; were the subsidy 200 basis points, the cost in the first year would be $20 million for every $1 billion of lending.

The rationale for the subsidy element is its catalytic role in facilitating a strong commitment to both prudent macroeconomic policies and pro-poor growth policies. The lower interest cost of the SSF, even if modest, would make it financially and politically easier for governments in eligible countries to address their long-term social (MDG) objectives, while maintaining a sound fiscal stance. The SSF would therefore address the chronic problem of high debt; lending over the long term (8-10 years), on a less concessional basis than PRGF but on more concessional terms than typical stand-by agreements (e.g. close to LIBOR);The facility would include two types of conditionality:

- Expected progress towards better debt indicators;
- Pro-poor growth conditionality, to limit moral hazard by scheduling disbursements to rise from low to high rates, in a predictable way.

Among the benefits of this facility the authors pointed to the lower cost of borrowing and the fact that its availability could also lower the cost of private borrowing, increase fiscal space and facilitate pro-equity structural reforms.

The representative of India expressed his concern about the proposed facility entailing moral hazard. Along similar lines, Mr. Torres argued that this facility might involve bailing out private creditors. Also, he pointed out that since the world is experiencing falling debt/GDP ratios; the initiative might be running

against the tide. He did not think there was a need for such a facility at this time. The representative of Nigeria, who favored the proposal, also doubted this was the right time for such a proposal.
The representative of Pakistan pointed out that the proposed facility implied an onerous increase in debt, since it implied an increase in external debt, and the associated exchange risk. He suggested that a facility of this sort would be more practicable if the World Bank were also included.
Finally, the representative of Philippines expressed his concern in that the proposal of such a facility by G24 might raise questions regarding the seriousness of country's current fiscal consolidation efforts.

The presenting author expressed her understanding of the signaling question. As regards the concerns on creditor moral hazard, she argued that such concerns should be factored into the design of the facility, and should not affect whether one should put forth such a facility. As to the timeliness of a SSF at present, the author pointed to the fact that some countries in Latin America are currently not growing and may need precisely this type of facility. Finally, she agreed in that this could be joint IMF/WB facility.

V. Lauren Phillips presented a paper titled "Lead, Follow or Get Out of the Way? The Role of the EU in the Reform of the Bretton Woods Institutions". The paper seeks to analyze the likelihood of reform in the Bretton Woods Institutions (WBIs) in view of the different interests within the EU.
According to the author, the US is keen to see a reallocation of quota votes during the Singapore meetings, a minor reallocation of power from European to Asian economies, to prevent BWIs, the Fund in particular, from 'slipping into obscurity'. UK had recently advocated a similar position.
As to the role of the EU in the BWI reform, most have assumed that Europe's weight will be reduced, and that its new veto power will convince Europe to give up quota shares. However, the EU response to the current proposal has been fairly negative, reactive rather than proactive or strategic. Despite the benefit a unified position would bring to Europe, a common European position on the topic is difficult to achieve given complex power sharing arrangements. After pointing towards several obstacles (legal, policy determined and political) to a single European representation, and various institutional complexities involved in such a process (the interlocking of supra-national, international and intra-national jurisdictions), the author expressed the rationale for the possible support of some EU countries to reform; from a Franco-German alliance to the incentive for smaller European countries to participate in decisions.

The presentation concluded by pointing to a "window" of opportunity for moving ahead in 2007, when Germany will hold the Presidency of both the EU and G8. But that would require that Europe block the current US proposal by producing an alternative proposal which calls the US bluff on global governance, as well as consensus building within Europe and among non-

European countries. In turn developing countries could refuse the current US proposal in support of a more far reaching EU proposal initiated by the Germany presidency.
The representative of Pakistan expressed his doubts as to whether the US has an actual proposal. According to him, the US is not willing to accept a general increase in quotas; only a redistribution, i.e. a zero-sum game. That, of course, is very difficult to engineer because it is not possible to reduce quotas without agreement of the countries concerned. The US proposal entails a fight for shares between EU and the developing world.
The representative of India anticipated the proposals that to his knowledge would be put forth before the IFC:

- An ad hoc increase for some under-represented countries, namely Ireland, S. Korea, Singapore, China, Mexico, Turkey and Malaysia.
- A reduction in over-represented countries (according to the current formula), India, Russia, Saudi Arabia, Argentina, Australia, South Africa.
- Under this rearrangement, all African countries would lose representation.

Mr. Buira pointed out that the ongoing discussion on governance reform is being conducted without revising the quota formula. He reminded delegates that G24 ministers had proposed the formula should include GNI measured in terms of PPP and the variability of receipts from exports and capital flows. Using such a formula, developing countries would get more than 50% of quotas since they already account for half of the world's GNI, He suggested that those were the grounds for rejecting the current proposals. He argued that G24 should stick to this fundamental position, which was approved by ministers.

The representative of Nigeria argued that reform could not happen without European cooperation. But this is unlikely for the reasons mentioned in paper.

Mr. Torres considered there is no US proposal. He argued that there is only a proposal by the Fund's Management, consisting of an ad hoc increase in quotas for underrepresented countries (based on calculated quotas under the current formula). Such a reform would imply more legitimacy, but in a very minor measure. According to Mr. Torres, Europe and the US oppose this proposal as long as the Chinese do not float their currency. Finally, he expressed his agreement regarding the convenience of not accepting anything short of real reform, which would involve a PPP based calculation of GDP, as well as the reduction of the weight of openness indicators in the calculation. A single European representation would make some seats available in the Board, but that would not solve the legitimacy problem. The main issue is whether developing countries can have greater weight in the decision making process.

The presenting author agreed that the current proposal was not a real option, not a genuine attempt to reform governance, and stated that the G24 alternative reflects better what the countries involved stand for.
Mr. Buira added that during the Spring meeting the G24 might draw on the position taken a year ago on this issue, supported by the research papers presented in Manila.
To conclude, the Chairman (Philippines) suggested delegates define the position of the G24 on quotas, legitimacy and effectiveness of Fund for the coming ministerial meeting, on the basis of the G24 Ministerial Communiqué.

VI. Rolph van der Hoeven presented a paper on “External Openness and Employment: The Need for Coherent International and National Policies”, which he coauthored with Malte Lübker.
The authors argue that of the two aspects of external openness (trade liberalization and financial liberalization), only the effects of the former vis-à-vis employment, poverty and inequality have been thoroughly discussed. But that been the case as regards the effects of financial liberalization on poverty and inequality.

After briefly reviewing the recent experiences with trade liberalization,-by itself it does not create growth and employment and can entail major adjustment costs- the paper argues that the effects of financial liberalization on employment and incomes often mean great setbacks for economic and social development. Therefore, financial liberalization warrants at least as much attention as trade liberalization. The paper weights the potential benefits in terms of growth against the adverse effects of volatility and crises that are frequently associated with financial liberalization, and in particular with debt and portfolio flows.
The authors point out that, contrary to market reformers’ expectations, more capital flowing around has not increased world investment rates. Indeed, country level studies show there is no relation between account liberalization and growth. Financial liberalization is associated with larger consumption volatility and increased growth volatility, as argued by the often cited paper by Prasad, Roggoff et al. Along these lines, the authors argue that volatility is difficult to deal with and obstructs growth.
The paper is motivated by the concern expressed by the World Commission on the Social Dimension of Globalization that “gains in the spheres of trade and FDI run the risk of being set back by financial instability and crisis” and draws the conclusion that volatility in international financial markets is currently one of the most harmful factors for enterprises and labor in developing countries. Indeed, the impact of financial crises on employment tends to be pervasive, including higher unemployment, increased informal employment, falling real wages, higher poverty rates, drop in labor share in national income, etc.
Hence, the paper suggests how greater policy coherency between international and national financial, economic and employment policies can give greater attention to employment and incomes. The paper proposes three areas for policy coherence:

- Policies in industrialized countries: Exchange rate coordination by the G3, including the stimulus to European growth;
- Multilateral rules: The rational integration of developing countries into the financial system;
- Policies in developing countries themselves: To avoid “corner solutions” in the open economy policy space trilemma, by establishing intermediate levels of capital account liberalization, more instruments (e.g. social pacts between employers and workers for inflationary policies), and intermediate exchange rate policies (e.g. active Competitive and Stable Real Exchange Rate regimes a la Frenkel), which involve higher levels of employment and capacity utilization.

For these policies to be implemented a broad consensus would be required; for which institutions for conflict management become crucial. In short, according to the authors growth depends on good institutions and an adequate policy framework. They also stress that more attention should be given to distributional issues; but unfortunately redistribution is not usually in the international agenda (e.g. MDGs).

Mr. Torres expressed his concern regarding labor market flexibility, a typical IMF recommendation and conditionality, and suggested the possibility of requiring ILO reports as a prerequisite of IMF’s assessment of labor market situations and policies in member countries.

The representative of Ghana was interested in learning more about how to deal with capital inflows and the excessive accumulation of international reserves.

As to labor flexibility, the authors responded that flexibility can only work where there are certain conditions to provide protection to workers, i.e. unemployment benefits, training opportunities; what ILO calls “flexi-security”, as established in Denmark, Sweden, Ireland. The challenge is to transfer those institutions to less developed countries.

As regards international reserves, the authors clarified that reserves are in fact useful—that what is not useful is the *excessive* building up of reserves. However, the excessive accumulation of reserves is a consequence of the countries mistrust in the international financial system.

VII. Mehdi Shafaeddin presented a paper titled “Does Trade Openness Favour or Hinder Industrialization and Development?” The author argues that there is neither a theoretical justification nor historical and empirical evidence to support what he refers to as “trade liberalization hypothesis” (TLH).

The theory behind TLH is the doctrine of comparative cost advantage which can not be used as a guide to caching up and achieving a dynamic comparative advantage which is a policy-based effort. Almost all successful industrializers went through a long period of selective infant industry protection before gradually subjecting their industries to trade liberalization. The forced trade liberalization imposed on the third world during the colonial era led to their de-industrialization, to specialization in primary commodities and underdevelopment.

On the basis of an empirical study of a sample of developing countries which have undertaken trade liberalization during the last quarter of a century and the case study of Mexico, which has been a champion of liberalization, the author also concludes:

- That trade liberalization is essential when an industry reaches a certain level of maturity, provided it is undertaken selectively and gradually;
- That the way recommended by neo-liberals under the label of "Washington Consensus" is a recipe for destruction of the industries at their early stages of development;
- That if through NAMA negotiations of the Doha Round, the developing countries submit to demands of developed countries by accepting their proposed Swiss formula, with a low coefficient (10), and binding of their tariff lines at low levels, this would halt their industrialization process;
- That low income countries and others at early stages of industrialization, in particular, will be trapped in production and exports of primary commodities, simple processing and at best assembly operation and/or other simple labor intensive industries.

Finally, as international trading rules are not conducive to industrialization and development, the author argued the need for a different framework of industrial and trade policies; such a framework would require a radical change in international trade rules. Developing countries should not be worried, the author emphasizes, if they are "blamed" for defending their policy autonomy in order to enhance their development.

The representative of Nigeria suggested that Brazil and South Korea are not good historical examples, because they have had access to inexpensive and skilled labor, a key input to attract TNCs, which are the main engines of export-led growth.

Given the emphasis laid on industrialization as the means to development during the presentation, the representative of Ghana asked whether development should always come about via industrialization, as opposed to, for instance, the agricultural or service sector. It did not matter where development came from.

Martin Khor expressed his agreement with main thrust of the presentation, namely, that liberalization may be positive at the right time, but harm developing countries if pursued prematurely, and expressed his concerns regarding current negotiations at WTO (i.e. the "Coefficient of 10" proposal), would force a significant reduction of industrial tariffs in developing countries, resulting in de-industrialization, balance of payments problems and reduction of government revenues (as many developing countries rely heavily on tariffs for revenue).

Mr. Torres pointed out that IMF trade conditionality only applies to countries which borrow from the fund, an asymmetric situation in trade negotiations. He mentioned that in Hong Kong it was agreed that IFIs should not require liberalization beyond WTO obligations. He also expressed some concern regarding protection and rent-seeking under weak institutional environments and requested some elaboration regarding Special and Differential Treatment (SDT).

The representative from Pakistan pointed that the size of domestic markets is important if infant industry protection is to hold. Hence infant industry protection may only benefit a dozen larger countries. He also expressed his concern regarding TNCs, which may often be larger than governments, implying unequal competition. He pointed to some of the examples provided in the presentation (Aviation in Brazil; salmon in Chile; pharmaceutical industry in India) as "lucky developments", not valid historical examples of successful infant industry protection. .

The representative of Egypt pointed to the situation "on the ground", as one characterized by weak institutions, restrictions imposed by market size, etc; pointing that it is difficult for other countries to emulate South Korea.

The author addressed all these issues in a general response. He acknowledged the problems of feasibility and rent-seeking, and argued that industry protection creates unproductive rent-seeking if no performance criteria are established in return. He also pointed to the question of market size. While there could be relevant restrictions at that level, it is essential to improve institutions and capacity for development; that is the key question. He also rejected the idea that the only key to development is held by TNCs, asserting that many countries had not developed through TNCs.

As regards Special and Differential Treatment (SDT) clauses, the author pointed that they are not binding; and that SDT clauses should be regarded as the rule, not the exception. To conclude, he mentioned that it should be a rule to treat countries at different levels of development differently; that this would entail a completely different WTO. In Brazil aeronautical development was not due to luck but policy; it began in 1948 and continuously supported the domestic aircraft industry.

VIII. Kym Anderson presented a paper on the "Incidence of Trade and Subsidy Policies on Developing Country Welfare, Exports and Debt Sustainability", which he coauthored with Will Martin and Dominique van der Mensbrugghe**.**

The paper and presentation were intended to highlight the large potential gains from trade liberalization that could follow a Doha round success.

The global impact of all merchandise trade distortions (including agricultural subsidies) are estimated by the authors using the latest versions of the GTAP database and the LINK model of the global economy (projected to 2015). Results suggest that developing countries' economies bear a disproportionate burden of current distortions, reducing their average income by 0.8 percent (and in Sub-Saharan Africa's by 1.1 percent) compared with 0.6 percent for high-income countries. A huge 63 percent of those costs are due to agricultural market distortions, even though agriculture accounts for just 4 percent of global GDP. As much as 93 percent of the cost of those agricultural distortions is due to import barriers, only 2 percent to agricultural export subsidies and 5 percent to direct domestic subsidies to farmers – although within that, the cost of cotton policies is mostly due to domestic support programs.

The authors also point that half of the overall cost to developing countries is due to their own policies, partly because they trade with each other fairly intensively and partly because their own trade barriers are higher than those of high-income countries. If all those trade-distorting measures were to be removed, the developing countries' shares of global output as of 2015 would rise from 70 to 75 percent for primary agricultural goods, and of textiles and clothing from 62 to 65 percent. Developing countries' shares of global exports would rise even more dramatically, especially in agriculture: from 47 to 62 percent in primary farm products and from 34 to 40 percent in processed farm products. That represents a rise in developing country exports of around $200 billion per year (in 2001 US dollars) – an increase of two-thirds compared with the baseline scenario for 2015 – and of $400 billion per year in exports of nonagricultural goods.

This amounts to more than six times the service the foreign debt of all developing countries in 2003. Cotton exports alone would rise by more than $4 billion for developing countries as a whole, almost half of which would be enjoyed by Sub-Saharan Africa.

In short, gains from trade would particularly affect developing countries, especially Sub Saharan Africa countries. But for these results to come about, agricultural reforms should be top priority.

Mr. Torres asked if, as regards special and differential treatment (SDT), unilateral liberalization would be favorable or unfavorable to developing countries. To which the presenting author responded that the effect of less SDT would very much depend on terms of trade consequences of more or less liberalization by developing countries. He concluded that while there is a chance that the terms of trade could move against developing countries, if developing countries did not participate in Doha there would be no Doha round at all.

The representative from Sri Lanka asked about the distribution of gains from liberalization among developing countries, fearing they might be concentrated in only a few of the largest ones. Furthermore, there may be even losers in the case of net food importing countries. To this the presenting author responded that even net food importers may gain from liberalization, if its effects on increased exports are factored in.

IX. Fernando Lorenzo presented a paper on the "IMF Policies for Financial Crises Prevention in Emerging Markets", which he coauthored with Nelson Noya.

According to the authors, financial crises in emerging markets should be understood following the standard open economy macroeconomics text treatment. This, however, could prevent practitioners from fully comprehending how to deal with such crises.

To deal with financial crises in emerging markets, the paper introduces what the authors consider more promising theoretical tools, borrowed from the interdisciplinary field of optimal policy design. The paper also considers the possibility that more than one market failure may occur simultaneously. The

authors intention is that the theoretical tools discussed in the paper should serve to improve existing prevention and management policies.
Admittedly, however, the interdisciplinary field of optimal policy design is comparatively young, thus offering scarce empirical support for disentangling competing models. Given this inability to decide upon the best possible model, the authors note two constraints that policy makers will deal with in the real world of financial crises:

- First, given that policy makers make crucial choices between parsimonious and innovative measures, the paper recommends parsimony because of the uncertainty regarding the true model.
- Second, high political implementation costs will always be present, and these are positively correlated with supranational institutional requirements.

Considering issues of both parsimony and political constraints, the authors argue that any attempt to harmonize rules and codes internationally must be undertaken with caution. With such a framework in mind, the presentation reviewed some of the recent proposals for emerging markets' crisis prevention. From the point of view of emerging countries and creditor countries taken as a whole promoting the adoption of GDP indexed sovereign bonds would be the best available proposal for crises prevention.

The representative from India suggested that IMF role as lender of last resort has become impracticable, due to insufficient funds, and that such a role cannot be "revived". IMF (principal) faces asymmetric information and is seen as not pursuing the first best solution. The IMF is not an independent arbiter. What can the IMF influence: Multilateral loans, Paris club loans?
Referring to Argentina's recent positive experience, Mr. Torres praised the proposal of introducing GDP indexed instruments.
The second representative of India called for caution a propos the authors' suggestion of involving the IMF in the international certification of GDP data accuracy, as that would add another layer of bureaucracy.

In response to these comments, the presenting author expressed his skepticism regarding the possibility of reviving the IMF's role of lender of last resort, and hence his and his coauthor's preference for the introduction of more drastic innovations; but acknowledged that such a policy stance would require strong support.
Mr. Buira indicated that, given recent experience and growing interest, there is a good possibility that G24 can host a joint seminar on GDP indexed bonds with academics, financial practitioners UN DESA and UNDP at the time of the Spring meetings.

X. Finally, Lucio Simpson presented a paper on "The Role of the IMF in Debt Restructurings: LIA Policy, Moral Hazard and Sustainability Concerns".
The paper states that the IMF's participation in debt restructurings has not been confined to fulfilling the role of expert, via the supply of information and analyses.

Rather, according to the author, the IMF has frequently exerted pressure on the debtors and its views have generally been biased in favor of the creditors' interests. In particular, the author claims that the Fund's lending into arrears (LIA) policy has been used as a means to induce debtor governments to "accommodate" creditor interests. But by providing financing to the debtor through its LIA policy the Fund could have potentially played a positive role in reducing the gap between the creditors' "reservation price" and the country's repayment capacity while, at the same time, assuring debt sustainability. But, according to the author, this is not what the IMF has been doing in practice. He concludes that the Fund should not support "market-friendly" sovereign debt restructurings that are incompatible with sustainable debt paths and may, paradoxically, represent a greater danger for its resources than more "coercive" alternatives.

The thrust of the presentation involved a critical analysis of the LIA policy. According to the author, the LIA policy enables the IMF to provide support to members that defaulted to private creditors, contributing to orderly debt restructuring. It is the Fund's main instrument to influence debt restructuring and induce necessary adjustment processes. Creditors benefit as it makes policies consistent. Lately, the policy has been less favorable for debtors, though; because, the "good faith" criterion (which requires debtors to show they are undertaking good faith negotiations with creditors) is not a clear one. A LIA policy requires:

- Early dialogue with creditors
- Information sharing
- Early opportunity to provide inputs to the restructuring process

It is up to the debtor to choose a modality; but the burden of proof is on his side and what would be required to comply with the criteria is not clear. Given this ambiguity, the IMF sought to refine this criteria, establishing that the debtor is supposed to negotiate with a representative committee (if such a committee existed). Also the IMF adopted a code of best practice, inspired by the private sector; but according to the author, this code has a creditor bias.
In practice, the LIA policy faces a significant operational difficulty in the ambiguity of the definition of the "good faith" criterion. While the Fund believes the solution is to clarify this criterion, author believes that would be an exercise in futility.
To conclude, the author analyzed the Fund's role in recent debt restructuring process ("coercive" vs. "investor-friendly" solutions), e.g. Argentina and Uruguay's restructuring processes. According to the author, in the case of Uruguay the IMF supported an "investor friendly" approach at the expense of debt sustainability. According to the author, "investor friendly" debt restructurings do not generate a "haircut" consistent with debt sustainability.
In its debt sustainability analysis the IMF should make sure the haircut is large enough, so that debt service becomes sustainable. Paradoxically, Argentina's unilateral solution seems to be more in line with a market outcome, but was not well received by the Fund.

In short, the author concludes that while LIA policies could potentially play a constructive role by bridging the gap between the interests of debtors and creditors, but thus far, its implementation has been inconsistent and has not been constructive, because of reasons that often seem ideological.

After the presentation, the representative from Pakistan praised the subtle difference the speaker had made between “market friendly” and “market outcome” solutions, and expressed his concern about the reaction of legal system in creditor countries with regard to hold outs. He also inquired about the relevance for LIA policy of the time period taken for a crisis to unfold. Finally, he wondered if the provision of Article V of the Articles of Agreement which could be interpreted to allow the Fund to assimilate a debt contract with an exchange contract, could ever be implemented.
As regards legal systems in creditor countries the author asserted that the power of hold-outs does not seem to have increased. As regards the time taken for a crisis to unfold, the author claims it may entail a significant constraint, as in the case of Argentina, where the crisis unfolded when the country was already highly indebted with the IMF, limiting the IMF’s own options. As to the application of Art V, the author expressed skepticism as to the likelihood of it ever being implemented in the manner suggested.
Mr. Torres for Argentina pointed that it would be a sensible thing to clarify meaning of “good faith”; from a legal perspective, “good faith” as innocence should always be presumed and did not have to be proven–as in the common law principle. Regarding the author’s comments on the IMF’s inconsistent role in Uruguay’s restructuring, Torres expressed some disagreement, given that such policies did avoid dramatic adjustments and costs of default.
Regarding the definition of “good faith”, in his final remark the author insisted in that defining good faith may be of secondary importance in a complex restructuring process.

After the last presentation was over, the Chairman presented his greetings to the attendants for what had been an excellent meeting and invited the closing remarks.

Mr. Buira pointed that we live in a ever changing environment, and noted that the G24 research work seeks to provide assistance and bolster the capacity of the G24 members and other developing countries to engage and participate effectively in the discussions on policy issues that arise at the IMF World Bank and ministerial committees. This was necessary as the IFIs governance structure did not ensure that the best interests of developing countries are always duly considered.

Mr. Torres indicted he had been asked by the Chair to list those points on which there had been broad agreement, hoping that they could find their way into the G24 communiqué during the Spring meetings:

1- Regarding global imbalances, he pointed to a consensus among the G24 that the necessary adjustment should not be simply left to the market and that there is a need for coordinated action, as in the suggested G20 accord. He suggested that G24 should propose this approach. Also in case a disorderly adjustment cannot be avoided, exogenous shocks facilities, such as the ones proposed during the meeting, deserve attention and need to be considered.
2-As to IMF reform, there is a legitimacy issue – who should decide on this reform? He pointed that we should be careful of supporting feasible solutions that end up preserving the current status quo, which short changes the developing countries.
3-Regarding openness and employment, flexibility per se does not guarantee growth as was discussed. He pointed out that the G24 should beware of supporting IMF conditions on the need for additional labor flexibility. A possibility is to request the opinion of ILO on labor market policies and related matters.
4- On trade liberalization, Mr. Torres said that it is clear that neoclassical assumptions are not realistic. The question is not about whether to liberalize or not, but the timing and conditions under which this is done. The G24 need to be careful in supporting trade conditionality at the IMF.
5-There is another concrete recommendation to pick up: the promotion of new debt instruments that link payments to GDP growth. As regards debt restructuring, the message is that “market friendly” restructurings are likely to differ from market outcomes. In any event, market friendly restructurings usually need financial support.

At the conclusion of the discussions, the representative of Pakistan thanked the Chairman for his able direction of the meeting on behalf of all participants.