

Impact of the crisis on developing countries
CONCORD Briefing Paper, February 2009

A. Introduction

The world economy is well into its worst crisis of a century. At the same time, the world's population is hit by a food crisis, an energy crisis, climate change, soaring poverty and a distressing uncertainty about how the economic turmoil will play out in the coming period. This is a crisis of the prevailing political and economic model of development focussed so unilaterally on economic growth. This requires a deep questioning of some of the fundamental paradigms which have again been brought to the light by the crisis: the model of economic welfare through economic growth and unequal distribution of wealth and the overshoot of natural resources, both the renewable and the non-renewable. There are some appropriate short-term responses, but that these must be accompanied by a search for fundamental changes in our economic models.

Despite their economical size, the long-time industrialized countries have already fallen into recession. Research and analysis demonstrates developing countries will be even more severely impacted. Trade and investment liberalization erodes domestic agriculture and industry, drastically undermines domestic savings and government revenues, and amplifies destabilizing capital flight. People living in developing countries notice a decrease in development assistance, due to the financial difficulties in the world. These trends and impacts could have tragic consequences for the most vulnerable and marginalized groups in a context of great precariousness, while the vast majority of people living in poverty bear no responsibility for this crisis. Moreover, the EU decision makers must acknowledge that macroeconomic, systemic, and financial issues are not gender-neutral and thus demand gender-aware policies. Past experiences have shown that crises and some responses, such as structural adjustment programmes of the IMF and the World Bank have disproportionately affected women.

This is a critical moment for global social and economic development. There must be decisive action, particularly from the European Union, not just to arrest the descent but to address the basic problems of distorted development that underpin these crises in the first place. The decisions European leaders will take in the coming months will affect people around the world therefore, especially in this time of crisis, European leaders need to be accountable to their own citizens, but also respect the human rights of all people when deciding on the wide range of policies that are necessary to address the current crisis.

B. What should be the key components of a comprehensive EU response to the crisis¹?

1. International financial and economic reform

At the Monterrey and Doha UN Financing for Development Conferences in 2002 and 2008 respectively, EU MS recognized that many aspects of the international financial and economic system exert a detrimental effect on development and poverty reduction. Commitments agreed in Monterrey and Doha require governments to tackle these problems to improve development. The EU must use its financial crisis impact package to take steps towards these reforms in line with the international commitments it has made.

Agreement on how to move forward on the impact of the financial crisis must be through a process of inter-governmental decision-making to take place within the legitimately, representative UN system. This should maximise the opportunity of the UN High Level Meeting on the impact of the financial crisis in developing countries, May 2009.

i. North South Resource flows

Illicit financial flows from developing to developed countries run at around \$1 trillion per year, eclipsing the amount of ODA money flowing from North to South. Finance lost in unjust financial transactions must be addressed by the EU if they are to realistically tackle the impact of the crisis in the developing world.

The EU plays a major part in maintaining the secrecy jurisdictions (tax havens) through which developing countries lose an estimated € 350 billion a year in **illicit capital flight**. EU governments must

¹ For more detailed policy positions on Financing for Development (debt, reform of IFIs,) please refer to CONCORD's response to the European Response on the Impact of the Financial Crisis, February 2009. On climate change, please refer to the CONCORD Manifesto for the European elections and the CONCORD AidWatch position on climate change financing.

systematically reform and regulate these jurisdictions, many of which are European. The Savings Tax Directive must be tightened up to force automatic exchange of information between all legal entities. The directive should progressively be extended to become a **global regulation**. As part of an aggressive **drive against tax evasion** the EU also has a responsibility to introduce other transparency measures, such as an accountancy standard for transnational companies to break down their accounts country by country. We also strongly call on the EU to give real teeth to intergovernmental work on reform of taxation, by a) supporting the **upgrade of the UN committee of tax experts** to the status of an intergovernmental body, providing sufficient resources to undertake its task b) moving quickly to adopt the UN code of conduct on combating tax evasion and avoidance; and c) by strengthening judicial and tax cooperation through information exchange, effective black-listing of non-cooperative tax havens and obligations to repatriate stolen assets). The EU response to the financial crisis must reflect effective reform plans to address these issues which have so clearly lead to decreased resources in poor countries.

ii. Debt – responsible lending

Debt has been a key contributor to the current financial crisis, and CSOs have long called for EU governments to cancel illegitimate and unfair debt. Creditors and debtors share responsibility for unsustainable debt burdens, and existing debt must be arbitrated through the introduction of a fair, transparent and **independent sovereign debt workout mechanism**.

Civil society calls for the EU to expand debt cancellation to all those countries that need it to achieve the MDGs, and to ensure that any new monies to tackle the impact of the financial crisis to be provided to developing countries in the form of grants and not loans. Any new loans that are agreed for developing countries by public or private lenders must adhere to the responsible lending principles.²

iii. Innovative Finance

We welcome initiatives to raise **innovative finance for development**. In the current context there is more room than ever for adopting innovative mechanisms that also help to regulate global finance. These new modalities must be targeted at the achievement of the Millennium Development Goals (MDGs), and tackling global challenges to sustainable development such as climate change and the costs of adaptation. These monies must also be demonstrably additional to ODA commitments, as set out in international commitments (UNFCCC). In this regard, the EU should introduce as a minimum first step of a Currency Transaction Development Levy and the auction of the carbon permits under the EU Emissions Trading System. Other initiatives, such as the High Level Task Force on Innovative International Financing for Health System, underlined the need to additionally fund health systems and health Millennium Development Goals.

iv. Reform of the IFIs

The EU response to the impact of the financial crisis on developing countries must recognize the role that IFIs have played in contributing to the current situation within which developing country economies are placed. The IFIs, as part of the UN system, must operate within the UN's human rights framework. There is a need for a revision upwards of the level of ambition of governance reform in the Bretton Woods Institutions, beyond what is currently on the agenda of these institutions. The EU must play a leading role in a **comprehensive reform of the Bretton Woods Institutions** in order to allow a greater voice and participation for developing countries.

The previous G- 20 meeting has not resulted in any meaningful course of action for reform of the IFIs. The need for decisive globally coordinated action remains. Civil Society groups, particularly in the South, are calling on a deep rethinking of the current global economic model which privileges profit over people and changes in the international financial institutions and trade and investment deals that implement this. We therefore urge the European Union countries to ensure a democratic and transparent global governance system. Decisions on the reform of the IFIs should be taken in fora where all nations are represented to be truly accountable to global citizens,

This includes reforming governance of the International Monetary Fund (IMF) and World Bank (WB) to make these more democratic and to give the widest latitude for developing countries to determine their own development paths. The role of the United Nations (UN) system can also be increased, particularly

²Please see the CONCORD Financing for Development position, October 2008

because of the reform of the international governance architecture would not be meaningful if it involves only the small group of countries, such as the G-20. The EU must therefore invest in preparations for the UN High Level Conference agreed at Doha.

iv. Foreign Direct Investment (FDI) as a development resource

Foreign Direct Investment (FDI) is an important source of finance in the poorest countries, as for example in 2006 FDI was equivalent to about 15% of gross fixed capital formation in the LDCs (this was 23% in African and Island LDCs). The LDCs as a group only received 0.7% of global FDI in 2006 and therefore FDI could be playing a much more significant role in these countries.

However, current trends in FDI suggest it currently has limited direct poverty impacts and is therefore significantly less development oriented than for example official development assistance (ODA). In 2004 about 70% of FDI inflows to LDCs went to economies dominated by mineral and oil sectors, sectors which have notoriously limited poverty reducing spill-over and backward linkages into the local economy. Even when it comes to infrastructure FDI, the vast majority (90%, in 10 of the 14 years between 1990 and 2003 in the LDCs) of this goes into telecommunication and energy infrastructure, areas with limited direct poverty impacts.

FDI therefore needs to be seen as a fundamentally different type of finance to developing countries - one which is less focused on reducing poverty and cannot necessarily be counted as contribution to development.. Trends in EU FDI should therefore in no way influence decisions about how much aid the EU should provide.

2. Official Development Assistance- ODA

ODA is a key component of the fight against poverty, and as a source of development finance is more important than ever, since the financial crisis has shrunk other sources such as private capital flows to developing countries. The global economic crisis, rising food and oil prices make early, predictable, aid increases all the more crucial, and MS must meet this need by providing ODA timetables, as committed in the May GAERC council conclusions. However, EU governments have failed to maintain sufficient rises in ODA levels, with increases leveling off between 2006 and 2007. Recent policy announcements by several European donors have raised the level of this threat.

Furthermore, donor governments have systematically, failed to take account of the structural weaknesses of the international financial and economic system which impact negatively on the development within poor countries at which ODA is supposed to be targeted. The revenue lost by developing country citizens to unjust international taxation regulation, illegitimate debt burdens, and unfair trade agreements benefitting industrialised country interests over those of developing countries are just some of the flows which dwarf the aid provided by rich country governments to the world's poor. **Reducing poverty will mean tackling all the policies which impact upon development**, stressing the notion of ODA as the only financing which is primarily targeted at reducing poverty, and reinforcing the need to separate ODA from other activities governments may classify as contributing to development. This means that EU ODA must be targeted at basic services; to ensure families ability to cope in the face of external shocks (such as the food and financial crises)

Any EU financial crisis impact response package must recognize both the need to protect ODA quantity and quality commitments, and the need to take account of the damage done to developing country poverty reduction by illegitimate financial outflows. The EU must ensure that its response to the impact of the financial crisis on developing countries:

- Reaffirms the EU's intention to meet aid commitments, and publish timetables by May 2009.
- Acknowledges that ODA is the primary source of finance for developing countries directly aimed at poverty reduction – unlike other flows which the EU may create and/or provide:
- Limits overall EU quantity contributions to developing countries to ODA: adding together the summary aspects of what is perceived by some to be a contribution to development from the EU will open the door to undermine aid

- Reaffirm EU support for and commitments on quality of aid as reflected in the EU position for Accra, the Paris Declaration and the outcomes of the HLF in Accra as reflected in the Accra Agenda for Action. Concrete steps towards targets should be outlined in implementation plans developed through consultation with government, civil society and parliaments in developing countries. Principles of aid quality should be maintained throughout all international meetings and accompanying documents.
- EU governments commit to eliminate economic policy conditions that constrain developing countries' policy space to take measures in the macro-economic, financial and social sphere to weather the multiple crises in the short term; and which reduce their long-term ability to institute country-specific models of development.
- EU governments should increase the concessional level of aid-labelled loans (this is particularly true for France and Spain) as donors could be tempted to stimulate their economic recovery by using foreign aid.
- EU governments need to confirm their commitments to untied aid and not shift aid allocations to mainly support infrastructural or productivity programmes in developing countries.

3. Climate change financing

The EU needs to respect the right to environmental justice at global level. It should also recognize its responsibility towards vulnerable communities around the world that are confronted with the impact of climate change by substantially reducing greenhouse gas emissions, contributing to adaptation efforts with additional resources and ensuring equal access to natural resources.

With increasing pressure to address issues of **climate change mitigation and adaptation**, safeguards are required so that monies announced are additional to the existing ODA pledges, as recognised in the UNFCCC. The principle of additionality must be extended to all new investment in development to ensure that the 0.7% commitments are protected.

Conclusion - Make EU policies coherent with sustainable development

In its response to the impact of the financial crisis in developing countries, the EU must clearly recognise the need for greater coherence in policies across sectors that affect developing countries in favour of development. An ODA+ approach means that trade, climate, energy and other relevant policies must take into account development objectives and reflect the EU's global responsibility to enhance social justice, equality and human rights. Any EU's *support plan for the developing world* must also be coherent with EU's policy commitments in the area of gender equality and women's empowerment outlined in the "EC's Communication on gender equality and women's empowerment in Development Cooperation" and in the CEDAW and Beijing Platform for Action. Matters of economic policy orientation, of trade, investments, debt-reduction etc. must be thoroughly reoriented from a consistent and comprehensive gender-perspective.

The EU should demonstrate how it intends to monitor this coherence principle through putting in place appropriate institutional structures mandated to highlight and remediate existing incoherence. The financial crisis impact response must be cross-referenced against the work on the EU's external action aimed at promoting greater coherence for development across the EU's policies and actors.