Shadow G*n* Meeting,

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Wednesday Session II

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A. How can (and should) developing countries engage in countercyclical fiscal policies?

a. What assistance is required from developed countries for safety net programs?

- Shift from aid to international taxation as basis for "federal-type" support
- Incentives in budgetary support for domestic tax reform
- Bias towards universal citizen benefit systems (social contract) with counter-cyclical dynamic
- Support for taxation of nationals' assets overseas; and foreign investors (UN Tax Model).

b. What assistance is required from developed countries for infrastructure programs?

- As above on taxation.
- Supported access to international sovereign bond markets; regional banks acting as market makers.
- Parallel with development of municipal bond markets in US; to mobilise local infrastructure funds

c. What conditionality should be associated with such programs?

- No macroeconomic or “reform” conditionality.
- Best practice public expenditure controls (e.g. EU regional support funds)

d. How can funds that are available in those countries with high liquidity be best channelled to developing countries?

- Issue is savings rather than liquidity; recycling surpluses without causing new debt overhangs.
- Long bond markets supported by market makers (eg regional development banks); just as in the case of regions within a country or indeed corporations
- This requires engagement of pension funds and insurance companies with long term commitment. SLF-type instruments send the wrong reputational signals.

e. Is there a difference between middle-income and low-income countries?

- main relevant difference is existence of local capital market with some depth;
- better distinction for CCPs is size and trade exposure which allows such policies of domestic demand management to be feasible;
- and of course appropriate institutional structure (including market expectations)regional arrangements otherwise.

B. Ensuring credit flows to developing countries

a. What is the best way to ensure a flow of credit to developing countries?

- Take into account the evidence that at least half of variations in such flows originate in home markets, and regional contagion (not host "fundamentals"). This is simply derived from the ICAPM models used by investors.
- Risk premium in particular is very sensitive to risk aversion (eg. US junk bond spreads accounts for most of aggregate change in EMBI)
- Thus G3 financial policy should take into account the externalities on EMs

b. What is the best way to prevent a credit run against firms in developing countries?

- Long bond markets supported by market makers (eg regional development banks) in domestic currencies [eg in Southern Europe pre-EMU)
- Prudential regulation of all financial intermediaries in terms of balance sheet exposures; backed by similar analysis for large clients.
- Reserve management related to short debt; and effective LoLR facilities.

c. What are the particular problems of Africa?

- Not a lack of external capital as such (FDI/GDP ratios among highest in the world). Lack of investment demand (risk) is.
- Less affected by financial market turmoil; due to lack of capital markets and local banks having disengaged from production.
- Key medium term factors are (agricultural, tourism) export supply, investment therein and infrastructure. This requires recuperation of development banking dismantled by the WB.
- Long term: fiscal reform and education.