Effects of the global financial and economic crisis on developing countries and on development cooperation

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PURPOSE: to propose a broad-spectrum strategy to support developing countries in coping with the crisis.

BACKGROUND: according to recent analyses, after the advanced and emerging economies, the "third wave" of the crisis has reached developing countries. The World Bank estimates that capital flows to developing countries will fall from 1 trillion dollars in 2007 to around 600 billion dollars in 2009.

The effects of the global economic slowdownare being felt in developing countries. The IMF expects developing economies to grow by a meagre 3.25% in 2009, down from 6.3% in 2008 and 7.9% in 2007. This economic slowdown is accompanied by a fall in global demand for commodities, lower export revenues and thus a slowdown in trade in developing countries. As a result, developing countries are likely to face a financing gap of 270 to 700 billion dollars in 2009.

Besides the purely financial aspect, the crisis may also have serious political and security consequences in the countries in question, in particular the most fragile ones: poverty and social unrest could turn latent political divergences into acute strife.

The Commission, therefore, considers that there is a need to take rapid action to ensure that the crisis does not affect these countries with even greater severity.

CONTENT: to come to the assistance of those countries under greatest threat, the Commission envisages a large arsenal of measures which may be summarised as follows:

1) activation of new resources: European overseas development aid (ODA) continues to be by far the greatest since the EU provides 59% of the overall total. In 2008, the rate of collective ODA was 0.4% of GNI, i.e. an amount of almost €50 billion (an increase in comparison with previous years). Despite this financial support, the outlook for the coming years appears rather problematic. Many Member States are far removed from the 2010 individual milestones and the additional effort to reach the collective target of 0.56% ODA/GNI in 2010 amounts to €20 billion. The Commission proposes that the Union uses all the sources and instruments available to leverage assistance aimed at stimulating growth, investment, trade and job creation. This would be achieved by:

- EU Member States honouring their individual and collective commitments to reach their ODA targets by 2010 and 2015. This will release an extra €20 billion in ODA in 2010;
- Member States should step up efforts to mobilise additional development-relevant finance. (e.g. building on ongoing voluntary solidarity levies, such as the airline tax to finance health programmes).

2) counter-cyclical action: the Commission considers that action is needed now in order to have a direct counter-cyclical effect in the countries in question. For this reason, it suggests that:

- priorities in the strategy papers and support programmes in 2009 and 2010 be redefined with a view to reflecting new needs and emerging priorities;

- disbursements and made more rapidly to a certain number of countries or regions in emergency situations;
- aid is frontloaded (€4.3 billion frontloaded in 2009 in the ACP countries);
- budget support is accelerated;
- macro-economic assistance is investigated for the European Neighbourhood Policy (ENP), accession and pre-accession countries.

3)improving effectiveness of aid: the Commission recalls that the dispersion of action undertaken in the developing countries has a considerable cost in terms of effectiveness. The volatility and lack of predictability of aid alone can increase costs by between 15% and 20% and that some calculations show that the cost of failure to apply the full aid effectiveness agenda could range from €5 to €7 billion/year. A coordinated European effort based on common priorities now has to be proposed. Several actions are envisaged:

- bilateral actions involving Member States and the Commission;
- collective European actions such as the setting in place of an EU approach towards cross-country division of labour with regard to development aid;
- collective EU approach to address the crisis;
- further reforms of the international aid architecture.

4) cushioning the social impact, supporting the real economy: several initiatives are envisaged to provide practical help to the countries concerned:

- **protect the most vulnerable** (women, children, the aged and disabled): the Commission considers that those most in need of help should receive assistance by: (i) taking targeted social protection measures; (ii) support mechanisms to safeguard social spending (via funding through the EDF, in particular);
- **sustaining economic activity and employment:** the aim is to create a maximum of jobs in the maintenance and building of local infrastructures. Several initiatives could be envisaged such as: (i) support for quick delivery infrastructure and job creation; (ii) the establishment of regional infrastructure in the Mediterranean (in the contest of the Union for the Mediterranean); (iii) an increase by €500 million by 2010 of the grant inlay in the EU-Africa Infrastructure Trust Fund;
- **revitalising agriculture:** although they have been falling gradually, food prices are always a subject of concern in developing countries. Revitalising agriculture in these countries requires a comprehensive approach: (i) speeding up financing for agriculture (e.g. by frontloading payments for the Food Facility with a billion euros); (ii) investment in certain agricultural corridors (align investments in support of linking markets and production areas);
- **investing in green growth:** the crisis offers a major opportunity to create greener economies, including in the least developed countries. The Commission suggests (i) supporting the Global Climate Change Alliance (GCCA) which seeks to boost support for the poorest and most climate-vulnerable developing countries; (ii) use innovative financing for climate change (the Member States should use part of the revenues from auctioning emissions allowances, as agreed in the European Emissions Trading System legislation for, amongst others, climate adaptation measures, afforestation, reforestation and technology transfer in developing countries that will have ratified the Copenhagen agreement). The Commission also recommends the Member States to explore the possibility of launching the Global Climate Financing Mechanism (GCFM); (iii) focus on renewable energy via projects funded by the EIB; (iv) support the transfer of environmentally friendly and sustainable technologies via the Global Energy Efficiency and Renewable Energy Fund;
- **stimulating trade and private investment:** the Union needs to act at two levels: (i) accelerate its Aid for Trade (AfT) strategy and respect the collectively pledged intent to devote €2 billion to trade-related assistance by 2010; (ii) promote the work on trade financing, extending the work under way in the G20, by increasing export credits, credit facilities and guarantees in order to stimulate trade.

5) strengthening governance: governance and fighting corruption are key to sustainable economic development. Several areas deserve special support. **Good governance in the fiscal area**, i.e. transparency, exchange of information, fair tax competition, and sound customs systems will increase domestic financial resources for development. Moreover **external debt** should be managed carefully. Countries in fragile situations (involved in conflicts or in crisis) will require specific attention and action; Lastly, this national governance agenda should be complemented by a strengthening of regional integration processes.

6)improve the institutional approach to the crisis: the Union's strategy to assist developing countries to cope with the crisis falls within a broader, global context which requires action from global institutions. A more efficient and inclusive world order is required. The ongoing crisis offers an opportunity to make the UN system and international financial institutions fit to tackle global challenges in an effective manner and the G20 should expedite the reform process. In this regard, the Commission proposes:

- that the UN must be in a position to effectively coordinate international efforts to help developing countries tackle a variety of global social, economic, financial and economic challenges;
- that the G20 keeps its promises by motivating the international financial institutions to act in favour of developing countries (this implies an immediate financing on the part of the G20 members of some 250 billion dollars);
- that regional and continental groups, such as the African Union or ASEAN, should be invited to participate in informal international economic platforms in order to vouchsafe greater efficiency and representation.