Global Crisis: Financial Meltdown, Contagion and Economic Shocks (Impacts and Responses)

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Global Crisis: Financial Meltdown, Contagion and Economic Shocks (Impacts and Responses)

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By Dr Clive Thomas | November 2, 2008 in Features, Sunday

The financial crisis and credit crunch

As promised last week, in this week's Sunday Stabroek column I shall start a fairly extended discussion of the staggering financial crisis and worsening credit crunch facing the global economy, The epicentre of these is the United States.

Historically, the economic record of market capitalism shows clearly that, from its earliest beginnings, substantial credit, financial, and economic crises have periodically occurred as this mode of production became more and more deeply entrenched among nations and in regions across the entire international economy. In its most recent phase of maturity, commonly referred to as 'globalization,' the periodic credit, financial and economic crises have continued unabated. Indeed, if anything, these are now being transmitted across the global economy at an unprecedented pace, if not instantaneously. These have also been more and more tilted toward their credit and financial dimensions as compared with previous crises. In this basic sense therefore, we can argue that the origins of the present crisis lie in the intrinsic dynamics of market-based capitalist reproduction.

Given this general observation, it is nonetheless true that over time these crises have emerged in different forms and with various textures and manifestations. The present difficulties first became apparent in the third quarter of 2007. Regular readers of this column would recall that I drew attention to this at that time when referring to the "triple whammy" as it was termed, facing the United States and the global economy. These were rising food prices, oil prices and serious weaknesses in the sub-prime housing mortgage market of the US. The crisis of rising food prices is not as much a priority now as it was then. The price of a barrel of crude oil is now less than half what it was at that time. The weaknesses of the United States sub-prime housing mortgage market has, however, intensified to unbelievable proportions.

Volatility

Over the past two months (September-October) both the scope and scale of the credit and financial crises have unfolded with dizzying speed across the global economy! During that period the stock market has also shown exceptional volatility, losing and gaining trillions of dollars from one day to the next in the market capitalization of firms listed there, while trending downwards. Thus the Dow Jones Industrial Index has lost double digit percentage points since mid-October.

The speed of transmission of the present crises has added enormously to its complexity. As matters now stand it would require some serious effort on the part of readers of this column to fully grasp and comprehend the main outlines of the present difficulties, let alone to be able to discuss the various solutions on offer intelligently. In my recent columns on the EPA I had advanced the view that the complexity and technical nature of the EPA undermined well-intended efforts to make it the subject of broad based public democratic discussion. This observation, in my opinion, is truer for the present crisis.

Technical terms

As an indication of this proposition I have listed below 15 technical terms, which invariably recur in all serious commentaries on the present financial crisis and credit crunch that I have come across in the public media. These terms are:

1. Bubbles (whether they are financial, housing, stock exchange or something else)
2. Herding behaviour on the part of buyers and sellers
3. "Mark-to-market" as the accounting basis for pricing assets
4. "Short- sellers" as a class of investors operating on stock exchanges
5. Inside versus outside regulation of financial and credit markets
6. Financial innovations as risk diversification
7. "Financial weapons of mass destruction"
8. Credit-default-swaps (CDS)
9. Structured finance and the securitization of assets
10. Derivatives and options
11. Transparency in contract reporting
12. Golden parachutes
13. Leveraging and de-leveraging of debt
14. Fannie Mae and Freddie Mac
15. Rating Agencies, which we do not yet have in Guyana

In the columns to follow I shall introduce all these terms and seek to explain their significance in context and in a manner that I hope is readily accessed by typical readers of this column. I wish to assure those not mindful of making this effort that it will be worth doing. As I shall endeavour to demonstrate, one of the most important contributory factors to the present financial crisis and credit crunch is that several of the key credit instruments on which the global financial system is grounded are opaque and not well understood by both buyers and sellers. When traded assets are opaque to buyers and sellers there are no ways to ensure that the prices of these assets reflect underlying market realities of demand and supply. As we shall see this is presently the main problem posed by the sub-prime housing mortgages.

Historically, all major financial crises and credit crunches associated with the workings of the capitalist economy have had, in different degrees, negative consequences on the real economy where goods and services are produced and distributed. These usually come in the form of unemployment, falling incomes, reduced private consumption, loss of consumer confidence in the economy, the wipe-out of pension earnings and so on. The most infamous example of this situation was the Great Depression of the 1930s. The

principal concern being expressed about the present situation is not simply that it is already the worst since the Great Depression, but that it might, if not aborted, out-match the damaging proportions of the Great Depression.
The issues surrounding this will be treated in subsequent columns.

As we shall see although the negative effects of the crisis on the real economy are certain, their full dimensions cannot as yet be foretold. The jury is open as to whether the global economy is in for a protracted slowdown, recession or depression.

Guyana and the wider world

By Dr Clive Thomas | November 9, 2008 in Features, Sunday

How is a credit crunch different from a financial crisis?

The enormity of the challenges posed by the present financial crisis and credit crunch is starkly revealed in its two most basic aspects, firstly, the enormous toll on the United States' financial system and secondly, the unprecedented scope of the governmental responses, which have been provoked.

The toll

At last count more than 60 financial institutions in the United States went insolvent or had to be rescued in the past six weeks. These include seventeen (17) commercial banks. And, among these casualties were massive banks like Washington Mutual and Wachovia. These two were taken over by JP Morgan Chase and Wells Fargo. The world's largest insurance company, (the American Insurance Group, AIG) was also overwhelmed. So too were some of the country's most prestigious investment houses like Bear Stearns and Lehman Bros.

During this period the scale of the sub-prime housing bubble became more and more evident. An estimated twenty-five (25) per cent of housing mortgages had mortgage value outstanding that was greater than the market value of the house. Not surprisingly, even the humongous mortgage institutions, Freddie Mac and Fannie Mae also became victims. The major US Stock Exchanges (Dow Jones Industrial Average, NASDAQ Composite, and the S&P 500) displayed exceptional volatility from hour to hour and day to day. Thus for the week ending October 11 the Dow Jones Industrial Average lost 18 per cent of its market capitalization value for the firms listed there.

On top of all these the slowdown in economic growth became more pronounced. In the third quarter of the year the value of US real GDP fell, reinforcing the widely held view that the country was firmly in the grip of a recession. Recent data on unemployment seem to support this outlook.

If one looked at the unemployment picture in the United States carefully one would have to consider not only the open unemployed, but those who are part-time workers who want to be full-time, as well as those that have given up on looking for work. These categories would cover what in Guyana are termed as the unemployed and under-employed.

Recent data published by the US Department of Labor show that while there are about 9.5 million workers unemployed in the United States, 6.1 million are involuntarily working part-time, in that they are looking for full-time jobs but cannot find them, and

1.6 million are no longer looking for work. This gives us a total of 17.2 million persons unemployed and under-employed, an equivalent of 11 per cent of the work force.

Amidst the carnage of collapsing financial institutions two financial precepts have emerged to the forefront of public discussion. One is the notion of a 'credit crunch' and the other is the status known as 'too big to fail,' which has been attributed to some financial institutions. Both of these are important technical terms, which I shall briefly elaborate on for the remainder of this column.

Credit crunch

Several readers have queried the title of my column last week, which listed the financial crisis and the credit crunch as separate phenomena. The reason for this is that technically, a credit crunch refers to a situation where there is an abrupt drastic contraction in bank loans or credit. In the present situation this has come about because banks in the United States are running scared over the quality of the assets being offered as collateral by potential borrowers. This phenomenon has become so widespread among banks to meet the standard of a massive credit crunch. Amongst those seeking to borrow are other banks, as well as firms and individuals. As a rule when credit or loans dry up, interest rates rise because of reduced supply. However, even at higher interest banks may still consider it too risky to lend.

Credit crunches can have other causes as we know from experiences in Guyana. Here the central bank and/or the government have in the past imposed sudden direct controls on commercial banks' lending, restricting the amount and type of loans or credit they are permitted to make. They have also through the use of operations on the money supply and reserve holdings of banks induced credit crunches for broader economic purposes.

At present banks in the United States have become suspicious that other banks would fail because the quality of the assets they are holding is poor and risky. At the peak of the banking collapses indicated earlier, there was a list of about 120 banks in the United States, which investors were speculating would go insolvent or require drastic support from other institutions or the government if they were to survive. One thing stands out in the US situation: the credit crunch was preceded by persistent risky behaviour by banks, particularly in the way they were valuing collateral on which they were making loans or giving credit. This means that their balance sheets were stuffed with overvalued and unrealistically priced assets.

From the description above it is clear that a credit crunch is very different from other types of financial crisis. Thus for example a bank may have a 'solvency' crisis with all its assets properly valued because independent of this there is a run on the bank. The credit crunch in the United States is different and entirely due to overpriced or 'toxic assets.'

Too big to fail

The other financial precept that has emerged into prominence is the notion that some financial institutions are considered as 'too big to fail.' In essence this means that the repercussions of their failure and the collateral damage to the broader financial edifice and eventually the real economy would be catastrophic. Government cannot possibly allow this to happen. The contradiction here is that the dynamic basis of the capitalist economy is survival of the fittest. That is, you make a profit or your firm goes under.

Next week I shall continue the discussion from this point by asking the question, what are the implications of this policy response.

Guyana and the Wider World

By Dr Clive Thomas | November 16, 2008 in Features, Sunday

At the epicentre of the crisis – a bursting bubble

In last week's column I put forward the thesis that, the enormity of the global financial crisis and its associated credit cr-unch could be gauged from two indicators. Firstly from the carnage they have already wreaked on the United States' financial system and secondly, the awesome scope of that government's response. Without a doubt the United States is at the epicentre of the global meltdown. I have already considered the first of these indicators and in the process of doing this introduced two important financial precepts. One is that a credit crunch is different from a financial crisis. And, the other is that some financial firms are considered 'too big to fail.'
The latter raises a number of systemic issues. One is that when firms take greater risks they expect increased profits for their risky behaviour. Such profits are privatized. When the risky behaviour fails and losses occur if the firm is considered 'too big to fail,' then taxpayers are expected to cover its losses. In such instances 'losses are socialized.' Such policies encourage firms to take risky behavior without risk to themselves. This is a clear instance of practising moral hazard.

Housing bubble
At the heart of the financial crisis in the United States is a private housing market bubble that has burst. And, because the United States is at the epicentre of the global crisis we can safely say that the proximate cause of the global meltdown is the bursting of the United States' private housing market bubble. In order for readers to fully grasp the significance of this diagnosis that, at the heart of the crisis in the United States there is a housing bubble, which has burst I need to briefly indicate: what is a bubble?

This is a technical term used by economists to describe a situation in a market for any asset whose price or face value is rising rapidly and continues to do so with little or no regard to its underlying or 'true' value. This happens because purchasers of the asset and the financial firms that lend them the money to purchase the asset convince themselves that not only will the price of the asset continue to rise but that in fact it cannot fall!

In retrospect, after the bubble bursts it seems unbelievable that those involved in the market could not see the continuous deviation of the face value of an asset from its underlying or true value was unsustainable. However, it frequently happens.

What is a bubble?
Let us look at an example of an asset with which most readers would be familiar even if they do not possess the asset themselves. If the shares in a company or titles to property have continuous rapid rises in their prices with no regard to the income derived from these, a bubble is in the making. The income from the share is the dividend it would pay

and from the property the rental value it could command. To purchase shares or property titles, purchasers would normally borrow money from financial firms using the asset as collateral. These firms would be willing to lend because in the environment of rising prices for the asset, using it for collateral against the loan used to purchase it would seem to guarantee repayment. If the borrower defaulted the asset could easily be sold to recoup the loan.

The classic definition of a bubble is “tr-ade in high volumes in prices that are considerably at variance from intrinsic values.” To be sure bubbles can be based on any asset. Indeed the asset describes the type of bubble. Thus a housing bubble is based on housing titles (mortgages). Financial bubbles are based on the general class of financial instruments. Stock exchange bubbles are based on the general class of stocks and shares. There have also been bubbles based on technical innovation, the so-called ‘dot-com’ bubble of the 1980s. There have also been other housing bubbles, for example Japan in the 1990s. All these bubbles have a common thread. That is, there is a speculative element as purchasers in the market are buying with the intention of selling at a profit.

Bubbles go through three distinct phases. First, there is a phase when the price of the asset is continuously rising. Purchasers of the asset borrow money from financial firms in order to enter the market. Lenders are quite willing to lend as loans do not look risky at all. They expect rising prices to continue. This is called ‘inflation based lending’ and is in fact a very risky policy to follow.

In the second phase of the bubble it becomes evident that incomes in the broader economy cannot sustain the current rate of inflation in the price of the asset. The face value of the asset begins to taper off. Purchasers are no longer willing to buy. Demand for the asset falls and so does its price. Lenders then become worried. They shift from inflation based lending to the standard and less risky ‘cash flow based lending.’ Loans dry up. And, as the asset price falls panic and anxiety hit the market for the asset.

In the third phase, the bubble bursts. The asset price collapses. Lenders now hold an asset that is now vastly devalued. Naturally they are unwilling to lend at any interest rate as the risk of default is great. In this situation several purchasers and lenders become, effectively bankrupt because they are left holding assets, which were bought at phony values. In the United States millions of households have found that the value of their outstanding mortgages is greater than the value of their houses. Many of these mortgages have been foreclosed and could not recover the sale of the outstanding value of the mortgage from the sale of the house.
This is indeed the heart of the financial crisis and housing crunch in the United States.

Next week I begin to outline the government’s response to this situation.

Guyana and the wider world

By Dr Clive Thomas | November 23, 2008 in Features, Sunday

At the heart of the crisis response: the US Troubled Assets Relief Program

The United States is clearly at the epicentre of the global financial crisis and credit crunch. The scale of the havoc and damage already wreaked on the financial sector of the United States is one of the two clearest indicators of the awesome seriousness of what confronts the global economy today. The other indicator is the unprecedented magnitude and scope of the United States government's response to this threatening situation. In previous columns I have discussed the first of these indicators. In this week's column I start a discussion on the second indicator.

Response
To begin with, the range of the US government's res-ponse has been breathtaking. At its core is the Troubled Assets Relief Program, called TARP. This was introduced by Henry Paulson, Secretary to the US Treasury and approved by the US Congress and President. A sum of US$700 billion was allotted to this programme, to be issued in two equal tranches of US$350 billion. I shall discuss the provisions of the TARP in the next section after I give readers some brief indication of the other important steps taken by the US authorities.

A key complementary measure was to increase the size of the deposit insurance guarantee offered to bank depositors by the Federal Deposit Insurance Corporation. This was increased from US$100,000 to US$250,000 per customer. This action was done to quell fears among millions of depositors of likely bank failures. As indicated in earlier columns there were lists of scores of US banks circulating on the internet that could collapse. The risk was that these rumours could lead to be a run on banks if depositors sought to withdraw their deposits for safety.

Another action was to adopt a policy stance supporting the precept of financial firms considered as being too big to fail, known as TBTF. As we saw in previous columns this means that some financial institutions would cause so much economic and financial damage to the US economy that failure of these would under all circumstances be considered unacceptable. As I had pointed out previously, such a policy stance encourages firms to practise 'moral hazard' because it removes the primary disincentive firms face in the capitalist system − the failure to make profit would lead to their certain closure.

Action was also directed at the Stock Exchange where a temporary ban was placed on short selling. In other economies stock exchanges were temporarily closed (Russia).

Although focused on rescuing troubled assets in financial depository institutions the TARP also included a commercial paper funding facility which supported in effect short-term loans to firms engaged in non-bank activities.

Troubled Assets
Rescue Plan

Originally, the primary goal of the TARP was expressed as the removal of "illegal assets that are weighing down the financial institutions and threatens the US economy." The focus was on financial depository firms. To achieve this objective the TARP had to command sufficient funds, hence the large sum of US$700 million. The expectation was that the TARP would provide stability to the US financial system, remove the credit crunch, and prevent the US economy from going into depression.

As Secretary Paulson posited when introducing the programme to the US Congress, "the underlying weakness in our financial system today is the illiquid mortgage assets that have lost value as the housing correction has proceeded." This statement supports the claim I made last week that the housing bubble was the proximate cause of the financial crisis and credit crunch that erupted in the US. The official Treasury view was that the illiquid mortgage assets were toxic, poisoning financial markets and threatening a deepening recession or worse in the real economy.

In the original presentation of the TARP the US authorities placed most of the blame for what was happening on 1) predatory lenders in the sub-prime private housing market 2) the lax supervisory and regulatory agencies which allowed irregularities and illegalities to spread in these markets 3) the securitizers who repackaged and resold these toxic assets as good value ones and 4) irresponsible households and housing speculators who succumbed to their own greed when the price of housing was rising way beyond its normal rate.

The long-run trend in US house prices tends to pattern closely the US overall inflation rate. At the height of the private housing bubble the rate of increase in house prices was several multiples higher than the inflation rate. This and other issues raised in the previous paragraph will be considered in later columns in the series.

As the crisis has progressed several new policy dimensions have been added to the US government's response, including as was mentioned last week, direct support for Freddie Mac and Fannie Mae, the two giant mortgage institutions in the US, and AIG, the largest insurance company in the US. Two other policy actions will be considered in detail beginning with next week's column. One of these is that the TARP programme has made a180° turn and is now to be focused on the purchase of preferred stock in the banks and their direct capitalization as a way of solving the problems posed by the illiquid assets parked in their portfolios.

The other policy stance is that the US government has worked very hard for a coordinated global response as the crisis spread at a rapid pace worldwide. The action culminated in the G20 Summit of leading financial authorities held last week in Washington DC (November 19-20, 2008).

Guyana and the Wider World

By Dr Clive Thomas | November 30, 2008 in Features, Sunday

An abrupt about face: From the Troubled Assets Relief Program to partial nationalization

From the inception the US Treasury authorities have made it clear that the primary objective of the Troubled Assets Relief Program (TARP) is to stabilize the US financial system and free the flow of finance to business. As they see it the problem facing them is located in the accumulation of illiquid mortgage assets parked in the portfolios of the major banks.

However, in the two months that have passed since the programme was introduced no noticeable progress has been achieved towards this objective. This has led to a dramatic turnaround in the approach of the authorities to the financial crisis and credit crunch.

Many critics have been pointing out that the TARP is providing a bail-out to the very institutions that have in their reckless pursuit of profits acquired these toxic assets. It is unfair to ask taxpayers to pay the cost of this risky behaviour. Moreover it is not only US financial firms that hold these assets, but foreign firms as well. The US taxpayer should not be asked to bail out foreign firms.

A related consideration is that the bail-out will add to the US budget deficit thereby placing inflationary pressure on the US and global economies. Additionally, the amount of funds available in the TARP is US$700B, which is only 5 per cent of the estimated value of US$14 trillion in toxic assets parked in the portfolios of financial firms.

Over the past two months the US economy and its financial system have encountered several reverses. The financial system has seen the bail-out of Citigroup bank, one of the largest banks in the country. It is now being reported that 171 US banks are at serious risk. In the real economy the three giant US automobile makers are also seeking US government help as they face bankruptcy (General Motors, Ford and Chevrolet).

TARP'S new focus

The TARP has been re-focused to purchasing preferred stock in banks and other financial firms rather than the purchase of their toxic assets. This measure extends US government ownership over its private banking system, much to the chagrin of some capitalist ideologues.

As the US authorities themselves describe it, the new goal is:

"The direct recapitalization of troubled banks and financial institutions through federal government purchase of preferred stocks, rather than the purchase of their toxic assets. This would better protect taxpayers and prevent unjust enrichment of negligent executives and investors.' The problem being identified here is that when toxic assets were being purchased under the TARP, the US authorities had no control over the use of the funds they released to the banks and financial institutions. Critics observed that in practice these funds were being passed on for the exorbitant remuneration of the very executives and investors who had created the problem in the first instance. In some instances the banks and financial institutions have also been using TARP funds to acquire smaller and/or weaker firms.

What the authorities have now done with the TARP is logical. Taxpayers would clearly prefer that their money is used to acquire stock in on-going and functioning businesses rather than to buy complicated bundles of securities, with unknown values based as they are on delinquent or foreclosed mortgages. One factor prompting this change in approach has been the continued volatility of financial markets. As I have argued the crisis is centered in the US private housing market bubble of the past few years, even though it is now truly global in its scope. Symbolically, several US economists point out that this new approach of the TARP patterns that previously introduced in Britain to cope with the spreading effects of the financial crisis and credit crunch.

Issues to follow

Over the next few columns I shall explain the global dimensions of the financial crisis and credit crunch as well as US-led efforts at a globally coordinated response. After that I shall proceed to examine the economic dimensions of the present situation, focusing on their likely effects on Caricom.

Having identified the private housing market bubble in the US as the proximate source of the difficulties the world economy and financial system now face, it is clear that in my view there can be no lasting solution until a way is found to remove the toxic mortgages from the financial system. The problem here is essentially two-fold. One is that the value of outstanding toxic mortgages exceeds the value of the houses now that the private housing bubble has burst. Foreclosure, therefore, does not recover the value of the debt (mortgage) outstanding. The other problem is that these mortgages have been securitized, that is, sliced, diced, and bundled into black-boxes of indeterminate securities that are unrelated to their underlying mortgages. The true price of these traded securities is both unknown and unknowable. There are no theoretical or mathematical methods that can determine their price, as the assets now have innumerable slices or tranches of mortgages embedded in them.

In theory given the supply of housing in an economy which is determined in large measure by the profits housing investors expect to make and the availability of investment funds, the price of this housing depends in large measure also on the demand for housing. Broadly speaking the demand for private housing is a function of household income, the availability of mortgage funds and demographic factors (the rate of formation of households). As we saw during a housing bubble this foundation price becomes divorced from the price of the mortgages as both lenders (financial firms) and borrowers (households) deceive themselves into believing the rapid inflationary housing prices prevailing reflect true values. Several ingenious solutions have been proposed to resolve this dilemma. Personally I believe the only one that might work is if the US bankruptcy courts were legally allowed to redefine mortgage values on houses being foreclosed, based on the good faith, due diligence determination of repayment schedules borrowers can afford and lenders are willing to accept − given their likely losses when foreclosures take place in these courts. This, however, would be a slow and long-term process as millions of mortgages are at risk. Steps will be needed to speed up this process.

Guyana and the wider world

By Dr Clive Thomas | December 7, 2008 in Features, Sunday

Global response to the global crisis

Within hours of the US authorities realizing that their private housing bubble had burst and how severe the financial crisis and credit crunch had become, reverberations began to be felt all around the world. Stock exchange and exchange rate volatility erupted in several other global markets. This caused near panic among both private investors and governments. Rapid speculative financial flows traversed the globe in their trillions of US dollars looking for temporary sanctuaries and safe havens where they could be parked. There was such a feeding frenzy of speculation that observers feared the worst as the contagion of this panic spread. The herding behaviour of private speculators imitated the instinctive behaviour one sees when herds of cattle are prodded into action by forces they cannot comprehend. This is not the behaviour one expects from cool-headed rational investors.

Immediately, several governments around the world took various emergency measures to protect their economies. Stock exchanges were closed, as in Russia. Short selling, (which I shall explain later in this series of columns) was temporarily banned. Central banks feared in particular what is termed "naked short selling." Some governments like those in Ireland and Germany went so far as to provide guarantees for all banking deposits in order to prevent the disastrous outcome of what is universally feared: a run on banks.

As all these consequences unfolded the need for a coordinated global response became readily apparent. Largely, but not entirely, because the crisis had first erupted in the US, the authorities there initiated and subsequently led the efforts of global cooperation. First the US sought bilateral cooperation with its major trading partners, Canada, China, and Japan. Secondly, the US directed concurrent efforts to promote cooperation with other major industrial powers, especially, the G8 group of countries. Beyond a doubt, however, the most important area of coordination is that extended to the G20 group of countries.

Although the crisis required responses that were way beyond the capacities of existing multilateral and international financial institutions like the IMF, the IDB and the World Bank, these institutions were kept fully involved in the search for solutions. Indeed they were expected to take the lead in coordinating policy changes affecting key financial instruments like interest rates, exchange rates and foreign reserves policies of national governments.

For the remainder of this column I shall present readers with a summary description of the G20 and the key measures, which it has adopted to cope with the present and any likely future financial crisis or credit crunch.

What is the G20?

What is the G20? The G20 was formed in 1999 and comprises a group of finance ministers and central bank governors from among the world's largest economies, both developed and developing, plus the European Union as a separate member. It includes membership from all continents and major regions: Africa, Asia, Australia, Europe, North and South America. Collectively the G20 accounts for over 90 per cent of the global GDP of US$67 trillion; 80 per cent of world trade; and about 70 per cent of the world's population. The IMF and World Bank and two of their associated forums also participate in G20 meetings.

The G20 is not a massive multilateral organization. It does not have a permanently staffed secretariat. It in fact manages its activities through what is called a 'troika.' That is, the current chair who is elected annually on a rotating basis from different regions, works with the future chair and the immediate past chair to provide a temporary administrative set-up for the chair's term. This arrangement is expected to provide the needed management continuity in the absence of a permanent secretariat. As readers would realize from the description above this is a very representative global grouping. It includes the leading industrial economies of the G7, Russia, and all the major emerging economies.

G20 summit − key results

Several far-reaching results have been arrived at during the G20 Summit held on November 15. For the remainder of this week's column I shall single out three of these for special mention in no particular order of importance. In next week's column I shall elaborate further on the decisions made at the summit.

One of the key results is an agreement to continue and enhance support for the process of continued WTO-led liberalization of world trade. This is considered critically important because if the present processes of globalization are halted now, the entire international system of market capitalism would certainly falter. Indeed the principal lesson to be learnt from the Great Depression (1929-1933) is that if during a global economic or financial crisis countries pursued what are termed by economists as beggar-thy-neighbour policies, this can bring world trade, investment, and financial flows to a screeching halt. These beggar-thy-neighbour policies would include competitive devaluation of currency exchange rates, the imposition of tariffs and quotas to keep out imports and protect domestic producers, or paying subsidies to national exporters in order to give them a competitive advantage.

A second important result is the commitment of the G20 to pursue the reform of the International Monetary Fund (IMF) and the World Bank. The key aspects of this reform process identified are 1) substantial augmentation of the financial resources to be made available to these institutions 2) changes in their modalities, procedures and ways of doing business, especially in relation to the developing countries and 3) major changes to their structure of governance. In particular it was agreed that the emerging market economies of countries like China and India would be given greater roles in the decision-making and executive authorization of these institutions.

The third reform that I would single out here is the commitment to the comprehensive overhaul of the regulatory, standards-setting and oversight of framework under which financial firms operate. This requires 1) changes to existing accounting rules 2) greater transparency of securitized assets 3) full independence and autonomy of rating and regulatory agencies and 4) guarantees for the disclosure, publication and dissemination of financial information by private and public bodies.

As readers would be aware from the above, the general goal is to redesign the existing 20th century framework of financial regulation to a 21st century one that is capable of monitoring and regulating financial firms in an age of mature globalization.

In particular, an age in which finance is hyperactive and the size of global financial flows is several multiples of the size of global GDP.

Next week I will continue with the discussion of this topic.

Guyana and the wider world

By Dr Clive Thomas | December 14, 2008 in Features, Sunday

Assessing the G20 Summit responses: Weak diagnosis equals weak solutions

Overriding considerations

Except by pure chance, ultimately the effectiveness of the actions proposed by the G20 Summit held on November 15, 2008 would depend on the accuracy of its diagnosis of the present financial crisis and credit crunch that are engulfing the global community. In this regard, I would argue that, from the perspective of the developing countries, three over-riding considerations should guide the summit's responses.

First, the need to confine as far as possible, the crisis situation that has erupted, only to those countries it has already engulfed.

Second, the need to prevent the spill-over of negative occurrences in the financial system to the real economy, where goods and services are produced and consumed for the private benefit of those concerned.

And, thirdly the need to preempt, if possible, future recurrences of such crises.

Regrettably, as globalisation has developed over the past three decades, one of its most distressing manifestations has been the periodic recurrence of serious financial crises of global proportions. Like now, each of the past crises has rocked the very foundations of private market-based capitalism on which the global economic, social and political order is predicated.

From the perspective of these over-riding considerations readers can appreciate the depth of uncertainty presently facing the global economy. To take an example, the domestic-based auto companies in the United States are blaming the present financial crisis and credit crunch for much of the immediate difficulties they face and are calling on the US government for "bail-out" support to the tune of several billions of US dollars. If help is provided to these US-based auto makers and not to the "transplant" auto sector (mainly Japanese) in the US, which has not called for a bail-out, this could be seen by the rest of the world as naked protectionism. In which case, history has shown that such inward-looking policies are always the worst policy choices from a global perspective, as they limit the spread of competitive global market capitalism.

The concern among many is that during the Great Depression (1929-33) such policies are now widely recognised as the main contributors to its prolongation over so many years.

Diagnosis
A good idea of how the G20 interprets the present crisis situation and therefore, might wish to proceed in dealing with it, can be gleaned from the causes of the crisis as they have identified them in their communiqué. Seven such contributory causes are indicated.

First, the G20 Summit blames the crisis on the under-appreciation of risks in the financial system by portfolio managers of financial institutions, particularly the banks and mortgage-lending firms.

Second, they blame the failure to exercise “due diligence” on the part of those financial firms that extended credit to borrowers.

Third, they further observe that this failure reflects a situation where financial standards were not being maintained, and indeed, they were falling.

Fourth, the decline in financial standards is reflected in crucial failures in the operations of the regulatory and oversight bodies established to prevent this from happening.

Fifth, as all this was taking place, they noted that poor management practices became apparent. And, sixthly, financial institutions got involved in excessive leverage as new instruments for structuring loans were introduced.

As a final cause, they have identified greed. This greed was exhibited by both lenders and borrowers. Lenders became involved in what was clearly “predatory lending.” At the same time, borrowers were accepting loans well beyond their means of possible repayment, based on their savings and likely future earnings.

As these causes helped to generate the crisis, insufficient global coordination of the macroeconomy, central bank actors, and trade policies allowed its rapid transmission around the world.

The G20 Summit communiqué makes the observation that between November 2001 and December 2007, the world economy went through an expansionary phase. In this period the growth of global output and incomes was strong. Capital flows around the world and among the emerging market economies (like China and India) as well as the leading industrial powers were robust. By and large, this was a period of fairly prolonged global economic stability, despite terrible political, cultural and geo-strategic conflicts.

Systemic concerns
The analysis of the causes of the crisis coming out of the November 15, G20 Summit fails to identify the systemic bases of the financial crisis and credit crunch. While each of the reasons indicated by them, as listed above, has indeed played a part in the evolution of the present crisis situation facing the global economy, these are in turn systemically related to underlying defects in the regime of private market-based capitalism, in an era of intense globalisation.

The blame for what has occurred has been placed by the G20 Summit squarely at the feet of actors and participants in global financial markets, rather than the systemic pathologies infecting the relation between the financial system, which is a product of market capitalism, and market capitalism itself.

Because of the rather superficial diagnosis of the situation, the proposed measures of the G20 Summit would not be able to prevent the recurrence of periodic crises, as globalisation proceeds. For this reason the interests of countries like Guyana would be best served if a means can be provided to de-link the defective operations of global financial speculation from the management of their external finances.

In this regard activist scholars and more progressive political leaders are calling for the creation of Regional Monetary Agreements and Exchange Rate Regimes tailored to the needs of developing countries. These mechanisms can provide for 1) external reserves pooling 2) securing temporary short-term assistance when balance-of-payments problems emerge and, 3) to reduce the need to use US dollars as the exclusive transactions medium for international trading.

Next week I will continue the discussion from this point and seek to examine some of the real economy effects of the financial crisis and credit crunch.

Guyana and the wider world

By Dr Clive Thomas | December 21, 2008 in Features, Sunday

From financial crisis to real economic crisis

Two issues need to be considered at this stage of the analysis of the financial crisis and credit crunch. First, to consider to what extent these financial occurrences have already negatively impacted the real economy. And, secondly, to evaluate the prospects for further damage, including spill-over effects to Caricom economies.

Several considerations confirm the already negative effects on the real economy and provide a gauge to future prospects. It would be useful, however, to begin the discussion by recognising two recent policy actions taken in the United States and Europe as an indicator of these effects.

Coordinated EU action

Despite sharp differences in the policy stances adopted by EU member states on the financial crisis and credit squeeze there was unanimous agreement to support a massive stimulus package of public expenditure to the equivalent of 1.5 per cent of the GDP of the 27 EU countries. This stimulus package is projected to complement that promised by President-elect Barack Obama after he takes office on January 20, 2009. The massive size of the EU stimulus package is a clear indicator of how seriously the authorities see the threat. This fiscal stimulus package has been accompanied by a coordinated reduction in interest rates. Indeed, in the US the Fed Funds rate has been reduced to its lowest level ever -025 per cent

Auto bail-out

The second set of actions concerns the efforts to prevent the collapse of the US domestic automobile makers. Congressional failure to provide a short-term bridging loan from the US government of between 15-34 billion US dollars to the three leading auto makers (Ford, General Motors and Chevrolet) will force the hand of the US President George W. Bush to act. Unwilling, no doubt, to end his presidency with the demise of the US once renowned domestic automobile makers an agreement will definitely be reached to provide some sort of assistance.

There should be no doubt that if the American domestic auto industry collapsed, the economic fall-out would be horrendous. Although the transplant auto sector (Japanese and European manufacturing plants in the US) would expand their production, the adverse effects on the US economy would be considerable. It is estimated that the industry, including suppliers of its inputs, car sales outlets, and finance houses account for about 10 per cent of US GDP and about 2.5 million jobs. Added to this there will be further fall-out in terms of reduced spending and tax payments by those who become unemployed and the associated firms that go out of business.

Indeed, it is estimated that the losses in tax payments from job losses and reduced expenditure in the US economy could comfortably exceed all the current estimates of the public funding required to salvage the auto industry. In this sense therefore the situation without a bail-out of the auto firms is likely to cost the US government more than the bail-out being requested.

Other sources of damage

While the two actions discussed above signify the magnitude of the economic problems posed by the financial crisis and credit crunch, they represent a tiny fraction of the total damage already done to the US and the global economies. The US is projected to lose 2 million jobs by year end. The rate of job losses has been increasing as the months have gone by this year, reaching over 530,000 jobs for the month of November!

As a consequence the US unemployment rate is estimated at 6.7 per cent at the end of November. This is a national average and as such it varies by region across the country. The expectation, however, is that particularly disadvantaged communities (like the north-east auto production belt) would be well above the national average. It is also expected that by year end the unemployment rate could be in excess of 8 per cent.

Accompanying these job losses there is the expected decline in tax payments, both as a result of workers losing jobs, and the decline in sales and profits for many firms. Simultaneously there is increased pressure for public expenditure on items like unemployment assistance. Consequent to the financial crisis and credit crunch, unemployment assistance has been extended by several weeks for recipients in order to take them through the year end holidays.

Inflationary pressure or deflation

This type of demand for public relief expenditure combined with reduced tax payments put inflationary pressure on the national budget. Indeed when all the various stimulus expenditure for this budget year is totalled, the expenditure can reach to US$1.5 trillion. The inflationary pressure on the US national budget and economy will be unprecedented.

Contrarily, the major fear expressed in the US is not inflation, but deflation. Deflation is a situation in which prices are falling as national output is declining. It is one of the worst manifestations of a depression.

Although as a rule economists believe they now have adequate tools to deal with inflation, they are far less confident about these when trying to bring an economy out of a deflation. The chief reason for this is that during a deflation, psychological considerations become paramount, as the business outlook discourages private investment and consumer spending. Expanding government expenditure, without complementary increases in private investment and consumer spending cannot by itself bring an economy out of a deflation.

Already in the US consumption spending has declined significantly and so have the sales of major retail outlets and service providers. Some well-known firms have gone into Chapter eleven bankruptcy. Business losses and reduced consumer spending discourage new investment and the expansion of existing firms. The consequence of this has been a recession which is defined as two successive quarters of GDP decline

Typically, economists have only been able to statistically diagnose recessions late, after the economy has turned around and is already on the upswing. This is of course because recent recessions have been short-lived. The official data however show that the US economy has been in recession for about a year now — since December 2007. Statistically, we also find that this is the worst recession for decades. Indeed, to some economists the US economy is probably closer to a depression than a recession.

The decline in consumption expenditure is very significant because about 70 per cent of total expenditure in the US economy is consumer-based. While this present decline reflects in the main the bleak economic circumstances prevailing with increasing job losses and reduced take home pay, it has been further accentuated by the credit card squeeze.

More than any other country US consumers create debt to purchase consumption items. They in fact dis-save. The effect of a credit squeeze on consumer spending can be, as it has been, quite dramatic.

Guyana and the wider world

By Dr Clive Thomas | December 28, 2008 in Features, Sunday

How will future economic growth be affected?

V, U, or L-shaped growth curve
Following last week's column, I shall discuss this week the impact of the financial crisis and credit crunch on the prospects for economic growth performance in the United States, the broader global economy, and Caricom. I will start the discussion on Caricom in next week's column.
At this juncture, economists are pointing out that it makes a big difference whether the chart or curve for future GDP growth in the developed countries takes the shape of a V, U or L. In the first instance, the V shape indicates a relatively sharp decline of economic growth into recession and an equally sharp revival in economic fortunes, after a very limited period at the bottom of the curve.

In the case of a U shaped curve, as the letter indicates, the economic decline is steep and the revival, when it comes is also steep. However, the time spent in recession at the bottom of the curve is much more prolonged than in the previous example of the V shaped curve.

The L shaped curve is normally indicated as an elongated L. Here the stay in recession (after the precipitous economic decline) is protracted. The economy finds it very difficult to overcome the downward drag on its growth, incomes and employment and the recession therefore, persists.
With these possibilities the most optimistic forecast out there is that recovery from the recession in the developed economies will not be underway before the start of the second decade (2010).

Monetary, fiscal and trade policies
It is concern over a protracted depression that drives the coordinated global effort to utilize monetary, fiscal and trade measures to stimulate global growth. Monetary measures have taken the form of reduced interest rates and the stimulation of bank lending. Global interest rates are now at record low levels. The present Fed Rate, at a quarter-of-one per cent, is the lowest rate ever for the US.

Fiscal measures have taken the form of both tax cuts and beefed-up spending by governmental authorities. The fiscal stimulus packages in the US and Europe, discussed last week, signify the magnitude of this effort. The International Financial Institutions (IFIs) have also concentrated on increased availability of funding for social, infrastructural, and poverty programmes in developing countries.

Trade measures, under WTO-guidance have been coordinated to ensure that countries do not restrict imports or subsidise exports in an effort to confer preferment or advantages to their domestic producers. Such policies are called 'beggar thy neighbour policies' and were major contributory factors to the prolongation and depth of the Great Depression of the 1930s.

To sum up, there can be little doubt at this stage that the global economy has already suffered major reverses in its real sectors, stemming from the financial crisis and credit crunch. Moreover, there is every prospect that these negative outcomes will intensify.

Spread of economic difficulties

Even high-flying economies with stellar growth rates have been badly impacted by the economic reverses. For example, China's economy has had the most explosive growth over the past three decades. This growth, however, has been export-based, and dependent on the US market. The recession has already hurt sales of Chinese manufactures in the US, leading to a deceleration of China's economic growth prospects.

There are two important barometers of expectations for future global growth. Firstly, the behaviour of securities prices on the various global stock exchanges. And, secondly, oil prices in the world market.

In so far as stock exchanges reflect future expectations about the performance of national and global economies, the trend in stock prices tends to be a good guide to the level of economic uncertainty among investors. In recent months global stock exchanges have shown exceptional volatility, even as overall indices of prices have trended downwards. Record swings in these indices have been recorded on all the major stock exchanges leading regulatory authorities to impose restrictions on investor behaviour. In the case of Russia, its stock exchange was temporarily closed!

If stock exchanges have been exceptionally volatile, the behaviour of oil prices on the world's commodity markets has been equally extraordinary. A year ago no one would have forecast that the price of a barrel of oil would reach US$150 by the third quarter of this year. Equally, no one could have imagined that it would fall precipitously to around US$40 per barrel, in the space of a few months!

While stock exchange volatility indicates the underlying uncertainty about the economic future, the drastic decline in oil prices indicates the near certainty in the expectations of investors that the world is facing a very serious recession. With recession and the decline in economic activity, the demand for energy as an input is certain to fall. The price decline in the oil market has factored in this expectation.

Back-burner

In some ways the most disheartening consequence of the financial crisis and credit crunch and their spill-over to the real economy has been to put on the back-burner of global attention, three very crucial global emergencies.

The first of these is the food crisis. I have considered this at some length, previously in these Sunday Stabroek columns. The second is the related problem of poverty, nutrition, hunger, homelessness, and deprivation that the Millennium Development Goals have targeted for global eradication.

The third is the issue of climate change and the global commitment to secure inter-generational equity, through preserving the sustainability of the natural environment for future generations.

Next week I will continue the discussion from this point.

Guyana and the wider world

By Dr Clive Thomas | January 11, 2009 in Features, Sunday

How are the global economic reverses channelled to Caricom economies?

Catching cold!
As the saying goes: when the rich developed economies sneeze, the rest of the world catches a cold, or worse, pneumonia. If we include the burgeoning emerging market economies among the group of developed countries, this saying would be even more apt today! The bursting of the private housing bubble in the US has led to a staggering credit crunch and financial crisis worldwide, culminating in arguably, the most severe economic recession, since the Great Depression (1930s).

More than the 1930s, today's global economy has become tightly integrated and no country is isolated from the economic reverses of late 2008. No one has anticipated either the speed, coverage, or depth of these economic reverses.

Initial surprise
After the initial surprise, Caricom leaders from all walks of life have been, by and large, behaving as if recent events are apart from their immediate concerns. Like the proverbial ostrich, leaders pretend that the knock-off consequences on Caricom's economy and society will be fleeting and ephemeral. This is indeed a discouraging state of affairs as the turmoil below the surface of Caricom's economy and society goes unrecognised and unattended.

In last week's column I began to explore the economic channels through which these economic reverses are likely to impact the region. As we saw, the severity of the impact will in large measure be determined by the shape of the economic growth curve in the developed economies for the coming period. That is, whether a V-shaped, U-shaped or elongated L emerges as the shape of the economic growth curve. Given this consideration, we explored in previous weeks five different channels.

Channels
To recap, we can expect firstly, those Caricom member states that are net-commodity exporters to be severely disadvantaged by declines in demand and/or prices for their exports. Trinidad and Tobago is the region's main commodity exporter (natural gas, petroleum and their related products). The catastrophic declines in oil and natural gas prices are unmistakeable. Secondly, those Caricom member states that are not heavily dependent on commodity exports, are heavily dependent on the export of services, mainly tourism and travel. These economies are also expected to face serious reversals in their

export earnings as economic recession in their main markets advances and their travel and tourism expenditures decline.

Thirdly, accompanying this decline in export earnings for both commodities and services, it can be projected that there will be a decline in the value of remittances sent back to the region as a result of recessionary conditions in North America and Europe, where the overwhelming majority of the region's diaspora lives. Added to this will be a decline in earnings from the region's 'guest workers' who participate in the organised import of temporary labour into North America (mainly for agricultural work). The fifth channel through which the adverse global events will be channelled is the portfolio holdings of Caricom firms. In the world's leading financial markets, two negative occurrences stand out. One is the decline, accompanied with exceptional volatility, in security prices. No major financial market has been immune. Secondly, as this has occurred, scandals, near-scandals, and the collapse of revered financial firms have littered the financial landscape of the developed economies. Unfortunately, there has been no reporting on the impact of these developments on Caricom firms. It would be safe to say, however, that the principal holders of such overseas securities in the region would have been negatively impacted. Certainly firms holding trust and pension funds, insurance companies and other related financial institutions, wealthy individuals and those holding the proceeds of organised crime would have been among the main victims of the financial fallout.

Investment flows: A special case

A sixth channel through which these adverse effects will be felt is investment in the region. This takes a myriad of forms: First, what is called 'official assistance' (aid in the form of grants and/or loans and technical assistance) will be curtailed. Already several of the G8 leaders, including President-elect Barack Obama have indicated that with the budgetary pressures facing their economies, it would be necessary to cut back on commitments for official development assistance. It is hoped that the international financial institutions (IFIs) will take up some of the slack caused by reduced government aid. A second type of investment flow that will be affected is direct investment in the region. This will come about partly because of the economic recession in the rich developed economies, and also as a result of proposed policy changes governing investment outflows from the rich countries. Thus President-elect Barack Obama has already expressed grave concern over abuses via investment out-sourcing and overseas tax-havens. If attended to, both these measures would have adverse effects on Caricom whose off-shore financial centres are major beneficiaries of present policies.

A third variety of investment, which will be affected, is the flow of investment funds from the diaspora back home. Many professional firms, services outlets, retail establishments, are financed by the diaspora. Such inflows are predicted to diminish as the recession in the rich developed countries intensifies.

Yet another type of investment which will be affected is securities holdings in regional firms. This will run the gamut from trade credit and commercial paper to equities and band holdings issued by Caricom firms. Again, the available data do not make it possible to provide reliable estimates of the value of funds likely to be affected.

In conclusion, the general effect of declining export demand, prices, investment inflows, remittances and so on will be adverse to the region's business climate or outlook. Doing business will seem more risky. The sales environment, and thus profit expectations for both home produced goods and services and exported items will be weak. This could have a significant cumulative effect on the spread of recessionary conditions in the region. Such an environment will put pressure on the welfare and safety net provisions offered in the region.

Next week I shall continue the discussion from this point.

Guyana and the wider world

By Dr Clive Thomas | January 18, 2009 in Features, Sunday

What will happen to the region's economy?

In the space of a few months the bursting of the private housing market bubble in the United States has produced a world-wide credit crunch, financial crisis and economic recession, all of staggering proportions. Overall, economic conditions in the rich industrial economies are perhaps the worst they have been there since the Great Depression of the 1930s.

Declines in their economic growth accompanied with increases in joblessness have occurred for most of the calendar year 2008. The financial fallout, after September 2008, has been immense. Several prestigious investment banks, mutual funds, regular commercial depository banks and other financial institutions have been severely threatened, or worse, with massive financial losses. These include the world's largest insurance company, the American Insurance Group (AIG); one of the world's oldest and most reputable financial firms, Lehmann Bros; and some of the largest banks in the US, like Bank of America, Citigroup and Washington Mutual Bank (WAMU).

Recap

In last week's Sunday column I had bemoaned the fact that the leadership elites of Caricom member states do not seem to be treating these momentous events with the urgency of purpose they demand. Yet so far I have been able to identify at least four major channels through which these global events are negatively impacting the region. These are 1) declines in both exports of goods and services; 2) reduced flows of remittances; 3) shrinking opportunities for temporary work overseas for Caricom workers; and 4) significant declines in the myriad forms of investment flows to the region. (These include overseas development assistance, private direct investment, portfolio flows, as well as investments promoted by the Caricom diaspora in North America and Europe). To these we might add that there is a decline in domestic investment and the channels which provide social provisioning and safety net protection to Caricom citizens who fall on hard times.

In today's column I shall conclude this discussion of the channels though which the global events are negatively impacting the region as well as my overall evaluation of these economic reverses, which started last September (2008).

Further linkages: Exchange rate

Added to those listed above, a crucial linkage between the region's economy and that of the rest of the world is created by the exchange rate regime adopted by the region. All Caricom economies are presently tied to the global payments mechanism through their link to the United States dollar. National governments and their central banks operate a fixed exchange rate tied to the US dollar and backed by reserves kept mainly in US dollar denominated securities.

All Caricom countries are also members of the International Monetary Fund (IMF), whose responsibility it is to provide regulatory oversight and monitoring of the global exchange rate mechanism, except for the Organisation of Eastern Caribbean States (OECS), which operates a unitary exchange rate mechanism under the Eastern Caribbean Central Bank. This apart, each individual Caricom member state is directly and solely responsible for its exchange rate mechanism. The exchange rate for local currency to the US dollar varies by country. Some countries have kept their rates steady for years (Bahamas and Barbados) while others have seen significant depreciation of their exchange rates to the US dollar (Guyana and Jamaica).

As the crisis has unfolded the US dollar rate has varied against other currencies, particularly the European Union's euro, the British pound, Japanese yen, Chinese yuan and the Canadian dollar. Similar variations occur in the region, as member states seek to maintain a fixed exchange rate to the US dollar.

Such induced exchange rate instability is a major source for channelling global economic effects onto Caricom member states. The main consideration so far has been the effects brought on though the euro-US dollar relation.

Timing: The EPA

This consideration leads us directly to the related issue of the timing of the global crises in relation to the commencement of the Economic Partnership Agreement, which was only signed late October (2008).

The region's primary trading partner for both goods and services is the United States. Despite this, its first modern comprehensive external trade and financial agreement is with the European Union.

The timing of this agreement from the region's standpoint, could hardly have been worse!

Ultimately, economic reverses in the rest of the world will take their toll on the region's poorest and weakest. This puts enormous pressure on the region's social welfare provisioning and safety net systems. In the past these have not performed very well so there must be great concern that events do not lead to worsening inequalities.

Global agenda

Finally, many of the major issues on the agenda of international development reform have a direct bearing on the economic prospects for Caricom. At this stage I would emphasize three of these, for my fear is that these concerns will be placed on the back-burner if the economic recession deepens in the rich industrial countries.

The first of these is rising food prices. For the first half of 2008 this was a major concern, as with high oil prices food supplies were being diverted to biofuels. The events in the last quarter of 2008 have overtaken this as a priority. However, the region is a net-food importer, so that a stable and permanent resolution of the issues of exceptionally high food prices will have to be attended to sooner rather than later.

Secondly, climate change threatens to wreak havoc on development outcomes worldwide. It is expected that the poor countries, because of a lack of resources, will suffer most from these developments. Caricom, comprised of island and below sea-level coastal states face dire physical effects if climate change were to intensify.

The third issue, which relates to poverty, nutrition, homelessness and economic marginalization is encapsulated in the Millennium Development Goals (MDGs). The achievement of these MDGs depends on the rich industrial economies keeping their commitments to provide development support. With economic recession on the advance in the rich industrial countries, these commitments are unlikely to be honoured. Failure to do so, however, limits the economic prospects for all developing countries, including Caricom.

There are of course, several other major global development commitments, which will be placed in jeopardy. The conclusion that the economic fallout on Caricom is likely to get worse is therefore plausible.

Guyana and the wider world

By Dr Clive Thomas | January 25, 2009 in Features, Sunday

2008: Shocks to the Guyana economy and its prospects for 2009

Shifting gears
This week I am shifting gears and stating a new discussion on the performance of the Guyana economy during 2008 and its prospects for the year ahead. It is intended that this discussion will lead into an assessment of the National Budget for 2009, which is expected to be laid in the National Assembly shortly.

Regular readers would recall that twelve weeks ago I had started an extended examination of the credit crunch, financial crisis and economic recession, which began with the bursting of the US private housing market bubble in the last quarter of 2008. This has since spread worldwide during the last quarter of 2008. My examination of those issues has turned out to be a rather longer task than I had originally anticipated. I am now forced to cut short some of this discussion as readers have expressed the wish that I deal with the Guyana economy in 2008 as quickly as possible, and certainly before the 2009 National Budget is presented to the National Assembly.

Although I have already briefly touched on the channels through which these external reverses have been impacting on Caricom and Guyana, this has not been, in my view, adequate. However, in the course of reviewing Guyana's experience over the past year and its prospects for 2009. I will necessarily have to treat with some further aspects of these external reverses on the region, as revealed by Guyana's experience.

2008: Two distant phases
To the close observer the Guyana economy clearly faced two distinct types of shocks an economic challenge during 2008. As we might fear, both of these have impeded growth and development, putting significant pressures on the levels of living of the vast majority of Guyanese. The first set of these shocks and economic challenges occurred in the first half of 2008. The second set of shocks occurred in the second half of 2008 – particularly the latter part of the third quarter of 2008 and all of the fourth. Let us identify the main shocks and economic challenges.

In the first half of the year the shocks and economic challenges were posed by two unprecedented global developments. These were, firstly rising food prices, and secondly rising oil prices. When these two merged the country also faced the related economic challenges of a bio-fuels bubble, with rising speculation over its global future.

Shocks of the second phase

The second half of the year saw numerous, but distinctly different shocks and economic challenges emerge. Indeed, these even took on an opposite character as for example, oil prices. These shocks and economic challenges were firstly, the bursting of the US private housing market bubble at the start of the fourth quarter of 2008. In a matter of days this was followed with the dramatic appearance of a calamitous credit crunch and financial crisis in the US banking system. Secondly, the economic fallout from these events was compounded by the US economy being at that point of time in an economic recession, although this was statistically unverifiable. Later, the official statistics showed that the economy had been in economic recession since December 2007.

Thirdly, in the space of a few weeks, if not days, these occurrences spread globally. By the end of 2008, there was a fairly general consensus that there was a global slow-down and possibly recession unfolding for 2009.

Fourthly, in this same period the threat of rising food and oil prices receded. Indeed, the price of oil fell from around US$150 per barrel to US$40 per barrel. Such a turnaround of oil prices gives support to those who had argued during the first half of 2008 that high oil and food prices were principally the product of speculation and not fundamental shifts in the demand and supply curves for energy and food. The drive for rapid biofuels production at all costs came to look absurd. Commodity prices generally, have fallen and the great fear for 2009 is now a global deflation. Related to these several considerations is their combined impact on Guyana's dollar exchange rate in relation to other currencies. Because of the operation of a fixed Guyana dollar exchange rate to the US dollar, the Guyana rate follows the US rate in relation to all other currencies. However, currency movements not related to the Guyana economy mean that the country's exchange rate has become a conduit for external shocks.

The final important set of shocks and economic challenge, which arose late in 2008 was that posed by the Guyana floods and the manifest pressures on the water management and drainage system. However, there were two other important developments, which did not necessarily follow this early and late-year distribution in their effects. The first of these was the wage negotiation process. Although the public sector wage was finally settled in the second half of 2008, as a process the wage negotiation and determination system produced negative economic effects throughout the entire year. The same thing can be said for the sugar industry. Although crucial decisions about its future were made late in 2008 (if not later) the negative impacts of sugar on the country's development were felt for the entire year.

Other shocks and economic challenges were caused by 1) The Economic Partnership Agreement (EPA) and 2) performance of the underground economy. The schedule below indicates the items I have identified above. My intention is to discuss these in the order listed in the coming weeks. The premise of my presentation will be that these shocks and economic challenges would have most certainly dominated economic performance and outcomes for 2008. Moreover, the prospects for 2009 will be seriously constrained by their lingering effects in the coming months. To believe otherwise would be to act like the proverbial ostrich.

2008: Shocks to the Guyana Economy

A 1st half of 2008

1. Rinsing food prices
2. Rising oil prices
3. The bio-fuels bubble

B. 2nd half of 2008

4. Credit crunch and financial crisis in US
5. Recession in US (December 2007)
6. Globalisation of 4 & 5
7. Commodity price falls (oil) – deflation
8. Guyana exchange rate mechanism
9. Bursting the bio-fuels bubble
10. Guyana floods
11. Wages mechanism
12. Guysuco modernisation stumbles
13. EPA (October 2008)
14. Performance of underground economy (UE)

Guyana and the wider world

By Dr Clive Thomas | February 1, 2009 in Features, Sunday

Economic challenges in the first half of 2008: Rising food, fuel prices and the bio-fuels bubble

In this week's column I shall begin a review of Guyana's economic performance during 2008, principally through evaluating the impact of three major shocks and economic challenges which rocked the economy during the first half of that year. As presented in last week's column the shocks and economic challenges during 2008 differed greatly between the first and second half of the year. Indeed, in that column, I displayed a schedule listing the 14 most important economic challenges of 2008. Three of these occurred in the first half of the year.

2008 Budget theme

The 2008 Budget was laid before the National Assembly on February 22 and had as its theme: "Staying the Course: Advancing the Transformation Agenda." That theme was no doubt largely guided by the uncertainty that faced the global economy in the early months of 2008.

Indeed, the Budget had recognized global economic growth of 4.9 per cent for 2007. This was, however, expected to falter in 2008 reaching only 4.1 percent. According to the Budget strong global growth in 2007 was fuelled by rapid growth of the emerging market economies (7.8 per cent for 2007), and in particular China, which grew at 11.4 per cent in that year.

During 2007, the phenomena of rising food and oil prices at the global level constituted the major external economic challenges. The general inflation rate for that year was 14 per cent. The increase in food prices, however, exceeded 20 per cent. Like others at that time, I am skeptical about the accuracy of these inflation estimates. However, I have to use them as they are in fact the only 'official' estimates for that year.

The 'official' overall inflation rate for 2007 did not accord with the anecdotal experiences of purchasers in local retail markets, particularly those spending on food items. Rising food import prices, plus the 16 per cent value added tax (VAT) on most retail items, did not square with a price inflation rate as low as 14 per cent and 20 per cent for the "overall" and food items, respectively. Nevertheless, these rates were in fact more than double those of the preceding five years!

During the first half of 2008, rising prices of food and fuel, which started in 2007, persisted. This occurrence dominated government's policy responses in early 2008. Further, as the year went on, the price of oil reached unprecedented levels and, despite the official statistics for January to June 2008, the prices of imported food items continued their relentless rise.

Shortly after June 2008 the Bureau of Statistics had produced an estimated inflation rate that was less than half the rate for previous year (6.8 per cent for January-June 2008). I have already commented on these statistics in previous public statements and in the process I have highlighted the course of certain prices (for example, milk and milk products), which no consumer I questioned considered plausible.

Effects of rising oil prices

The effect of rising oil prices was as devastating, as the increase in food prices. Oil is the main source of energy in Guyana. Price increases have pass-on effects, since every item reaching the final consumer requires energy to produce, store, and/or distribute. In addition, rising oil prices raise export production costs (particularly in non-sugar areas such as mining), as well as personal transportation costs.

The persistence of rising oil and food prices during 2008 clearly impeded Guyana's economic growth, development and job creation. Moreover, these two shocks were both exogenous, in that they arose from considerations beyond the control of the Guyanese authorities. Regrettably, these same authorities have sought to minimize or ignore the negative impact of external shocks and economic reverses on economic performance during 2008.

Bio-fuels bubble

As if the situation created by rising oil and fuel prices was not bad enough, the fusing of the two created a global 'bio-fuels bubble,' which affected Guyana. The basis of this bubble lay in the mistaken belief that rising food and oil prices in 2008 represented fundamental shifts in the global demand and supply schedules for these items! It was argued that the main causes for these shifts were 1) the spectacular growth of demand for food and fuel in the emerging market economies 2) the negative effects of global climate change on food supplies and 3) the disruptions and geo-political uncertainty in the Middle East.

I will not revisit these issues here, as I have already discussed them in previous Sunday Stabroek columns during 2007-2008. The main point I wish to reiterate now is that speculation has clearly dominated price behaviour for oil and food in the recent past. In addition, rising food prices globally are not a sustainable long-run phenomenon. The economic evidence shows clearly that as persons and nations' income levels improve, a diminishing proportion of that income will be spent on food. In this circumstance there can be no long run sustainable improvement in the price of food relative to the price of manufactures and services. Of course, this stipulation does not rule out supply shocks in the short run, particularly those caused by bad harvests. In the case of rising food prices during 2007-2008, the evidence now reveals that there were supply shocks in the food chain, but that the main cause of price increases resided in speculation in food and commodity markets. This was also true for oil prices in that period.

As I stated above, rising food and oil prices fuelled what I would term in retrospect as a bio-fuels bubble. Typical of such bubbles, speculation dominated the market place and players in both food and oil markets deceived themselves that bio-fuels, led by what seemed a continuous increase in oil prices, were also entering an era of continuously rising prices, growing demand and therefore increased profitability. Guyana got sucked into the bubble, with the authorities making extravagant claims about the potential of ethanol and sugar cane production as a solution to Guyana's energy needs, export earnings, and saving on import expenditure.

The later decline in oil prices, (by about 75 per cent of its peak level of US$150 per barrel in 2008) has brought the cold harsh light of realism onto the domestic energy market and has hopefully burst the bio-fuels bubble in the making.

As readers would realise these shocks of rising food prices, rising oil prices and the bio-fuels bubble posed serious economic challenges for the economy. As we shall see, however, the effects of the later shocks, which emerged in the second half of the year turned out to be far more devastating.

I shall continue from this point next week.

[Guyana and the wider world]

By [Dr Clive Thomas] | February 8, 2009 in [Features], [Sunday]

The worst-case scenario: Economic shocks in the 2nd half of 2008

Recap

In last week's column I considered three major economic shocks/challenges which rocked Guyana's economy during the first half of 2008. To repeat, these were the continued rise in 1) food prices 2) oil prices and 3) a speculative bio-fuels bubble, which threatened to delude the authorities into believing they had found a 'miracle' solution to Guyana's energy woes. The first two challenges/shocks generated strong inflationary pressures in Guyana (through rising import prices), as well as impeded export production (through rising input costs). The former effects were compounded by the value-added tax (VAT). Government's principal concern over this period was to mitigate these effects through various safety-net and relief packages, which focussed on its "grow more food" campaign, plant seed distribution, and aiding the development of farmers' markets.

Dubious economics data

Despite the obvious magnitude of these economic reverses, the official data do not fully portray their impacts on ordinary citizens. Indeed, the Bureau of Statistics had declared an inflation rate of only 5.8 per cent for the period January-June 2008. Over the same period it reported a dubious growth of real GDP of 3.8 per cent.
Remarkably these data indicate that the Guyana economy was insulated from the global shocks during the first half of 2008! Personally, however, I remain skeptical of this. I cannot prove though that the economic data are being massaged to support predictions of the authorities as some critics argue. Nonetheless, I share the widespread agreement that the bases of our national statistical collections need to be revised and improved.

Why rising food prices cannot last

Readers may not have been fully aware of the significance of the fundamental statistical relation between the demand for food and income that I introduced in last week's column. As I indicated then, this relation undermines (short of a global disaster that drastically limits food output), any long run tendency for food prices to rise and thereby to promote price imported inflation in net-food importing countries.

The fundamental statistical relation states that, as persons and nations get wealthier, a reducing proportion of their incomes will be spent on food. This relation holds true for all regions and cultures. Because of this demand growth cannot sustain a lasting tendency for food prices to rise. Short-term disruptions of supplies may affect prices in the short-term.

With the long run trend for food productivity to rise, even if at a reducing rate, I venture the opinion that rising food prices will remain exceptional occurrences and not the rule. This means that Guyana must guard against being sucked into a ‘food bubble.’ If food prices were to rise sustainably in the future, Guyana, as an agricultural-based economy, would find considerable opportunities, not threats or economic reverses.

The fundamental relation of oil production

I should point out that there is another fundamental statistical relation at work in oil production. Oil is a commodity that is ultimately in fixed supply. It can only increase through geological time. Because of this, once the annual global output of oil (or that of any region) peaks, an inexorable and irreversible decline in output is immediately set in place. After this decline commences the price of oil will rise sustainably.

However, there is no evidence that the global annual output of oil has peaked. Nor for that matter, is there strong evidence to show that this will occur some time in the near future. Unexplained rises in oil prices (as with food) are better explained by speculation and/or temporary disruptions in their annual supplies, including stocks.

Perspective

From this perspective the twin shocks of rising food and oil prices during the first half of 2008, bad as they were, could not be sustained indefinitely. As we now observe all commodity prices are in decline, particularly oil. The immediate threat is not inflation but deflation of commodity prices.

Bad as they were, these exogenous economic reverses, which occurred in the first half of 2008, pale in comparison to those that emerged in the second half of 2008, particularly towards the end of the third quarter and all of the final quarter of that year. Here, the worst case scenario occurred.

I displayed a Schedule two weeks ago (January 25), listing the fourteen major economic shocks/challenges of 2008. Eleven of them occurred during the second half of the year. The first of these eleven was the financial crisis and credit crunch in the United States.

Financial crisis and credit crunch

As I have previously explained in earlier columns (November 2 and 9, 2008) there is good reasoning behind my consistent description of the initial finanical fallout in the USA, as constituting these two elements. The credit crunch refers to the massive and sudden freezing of loans and credit by US commercial banks. This reflected the basic distrust they had for the securities on offer from credit seekers. It also reflected a great unease about their own portfolios of assets. The latter reflected the opacity of the assets being traded on the US financial markets. These assets came to be described as “troubled” or “toxic.” As these names suggest they were too risky to acquire, at any cost. The freezing of credit brought the smooth workings of the wheels of commerce in the US to an abrupt halt.

A financial crisis is different. It refers to a regular systemic dis-order of the capitalist financial system. Here while credit continues to flow, there is a definite cyclical periodicity to these flows. This cyclical periodicity is part of the normal rhythm of capitalist expansion and contraction. A financial crisis could be triggered by any number of factors. In the era of globalization, financial crises have become more global in scope, more easily transmitted from one country to another, and involve immensely large sums of money in comparison to the value of global GDP output.

What effect did these two events, the credit crunch and financial crisis, have on the Guyanese economy in the second half of 2008? I shall respond to this question next week, but readers would have already recognized that the Guyanese authorities have been playing ostrich, pretending and perhaps hoping these US based catastrophes would simply go away.

I shall continue the discussion from this point in next week’s column.

Guyana and the wider world

By Dr Clive Thomas | February 15, 2009 in Features, Sunday

Taking their toll: external shocks and the Guyana economy

In last week's column I had introduced the first of eleven economic shocks/challenges that rocked the Guyana economy in the second half of 2008. That was the "financial crisis and credit crunch" which erupted in the United States during September-October 2008. The epicentre of that first shock/challenge was the bursting of the US private housing market bubble. In retrospect, we can now observe that early signs of this untoward development passed virtually unnoticed as far back as the latter half of 2007. Remarkably, this shock/challenge continues to worsen.

Official acknowledgement of the desperate situation in the US only followed on the heels of spectacular threats to its financial system. Well established, and indeed hallowed financial firms, collapsed or approached the brink of collapse, necessitating unprecedented "bail-out" actions by the US government. Toxic mortgage-based assets in the US financial system, generated from the private housing market bubble have been estimated at several trillions of US dollars. In response to the situation, the US government hastily put together a massive 700 billion dollar "toxic assets relief program (TARP)" to help stabilize its financial system and unfreeze credit markets.

The financial firms caught up in this debacle included such famous ones as America Insurance Group (AIG), Bear Stearns, Merryl Lynch, Morgan Stanley, Washington Mutual (WAMU) and CitiGroup. This catastrophe led to a dramatic collapse of confidence, which allowed the credit squeeze to tighten its grip on the US banking system.

Negative impacts

There can be no doubt that these developments have had negative impacts on the Guyana economy at the outset. Worldwide, trade credit and banking credit became harder to get and more costly. This raised the transactions cost of external commerce for Guyana. Moreover, a considerable proportion of Guyana's wealth and income generation traditionally derives from the underground economy. Here organized crime proceeds, which had previously illegally passed through American financial firms, were now adversely affected. This in turn affected the ability of those who made their livelihoods through underground economic activities, to continue to do so. In turn, this further affected the livelihoods of Guyanese not directly connected to the underground economy but yet dependent on its expenditures.

In addition to this group of persons, wealthy individuals, not at all connected to organized crime, came under duress. By its very nature the impact of these reverses on wealth and income generation among the wealthy in Guyana is not easily measured and remains unknown. As a rule, the authorities seem to make little or no effort to monitor this aspect of the economy.

The repercussions of the financial crisis and credit crunch on US and global stock exchanges were also dramatic. Indeed volatility became the order of the day, as stock prices seemed out of control. The general trend, however, was downward, resulting in trillions of dollars worth of capital value being lost by US firms, which traded on the main stock exchanges, the Dow Jones, Nasdaq, and S&P 500.

The volatility in stock markets was repeated in the foreign exchange markets, particularly where this involved the US dollar exchange rate to the Japanese yen, British pound, the euro, and the Canadian dollar. However, because the Guyana dollar is traded at a more or less fixed rate to the US dollar, all these changes in the US exchange rate were immediately mirrored in the Guyana dollar exchange rate, without any reference to Guyana’s economic needs or development context.

Further, a more general consequence of this volatility in financial and foreign exchange markets was a substantial loss of confidence. The business environment consequently deteriorated rapidly. And, as confidence worsened, worldwide uncertainty ensued. As readers would be aware uncertainty is a mortal enemy of market-capitalism.

Guyana was no exception to this increasing uncertainty, although the authorities sought to imply at the time that these externally-driven economic reverses could not reach our shores.

Remittances, travel &
tourism and investment

Most Guyanese dependent on remittances are painfully aware that these are now under stress. The foolish claim has, however, been made that the decline in remittances is concentrated in countries whose overseas migrants chiefly perform unskilled labour. It is claimed that migrants from Caricom and Guyana are better-off, being skilled or semi-skilled.

Typically it is said they are teachers and personnel working in offices at the local, state or city level. But anyone familiar with the pattern of lay-offs in the US would know that if this statement is true, lay-offs are heavily concentrated among public schools and state/city employees due to budgetary shortfalls.

Guyana’s fledgling travel and tourism industry, based largely on vacationing visits by overseas-based Guyanese has been heavily impacted — although information on this sector is scanty. In the broader and more organised Caricom, data on travel and tourism show that visitor numbers have fallen by about one third. Empty hotels and large staff lay-offs have been announced in many countries, particularly Antigua-Barbuda, Barbados, The Bahamas, Jamaica and St Lucia. Even in Trinidad and Tobago where this industry is small in comparison to its massive energy sector, the impact of the economic reverse in the US is significant in Tobago, which reported a hotel occupancy rate of only one bed in three. These negative effects in the region also included the postponement of several previously announced major investment proposals in the sector.

All types of investment flows to Guyana also came under pressure, because of the loss of confidence and growing uncertainty. This continues today and includes official development assistance, private foreign direct investment, and investment from overseas-based Guyanese. The only exception to this trend is investment flows from regional and international financial institutions able to obtain counter-cyclical funds.

Conclusion

The impacts of the 'financial crisis and credit crunch' in the US have rapidly merged with the twelfth and thirteenth shocks/challenges to hit the Guyana economy in the second half of 2008. A US recession, albeit unrecognized at the time, had indeed started way back in December 2007. The financial meltdown and economic recession quickly spread around the world producing systemic shocks to globalization itself. This now directly challenges the dynamic basis of the world economy, as it has evolved over the past three decades.

I shall continue from this point in next week's column, taking into account the national budget's (mis)treatment of these issues.

Guyana and the wider world

By Dr Clive Thomas | February 22, 2009 in Features, Sunday

Budget 2009: From ‘voodoo’ to ‘make-believe’ economics

‘Voodoo economics’
Economics is essentially a discipline based on commonsensical principles and ideas. These are then expressed precisely, with logic and theoretical rigour. And, more often than not, they are supported with the use of mathematical techniques, and statistical analysis and inference. It is for this reason I believe that when government and its functionaries make economic pronouncements which violate common sense, ordinary Guyanese dismiss these as ‘voodoo economics’ or in other words, rubbish. The 2009 National Budget brings us face-to-face with an even more disturbing companion of ‘voodoo economics,’ that is, the economics of ‘make-believe.’
By ‘make-believe’ economics I refer to situations when the government and its functionaries put forward economic statements and prescriptions, which bear little or no relation to the realities of the everyday life of Guyanese. This happens because, like the proverbial ostrich, the government wilfully or otherwise ‘buries its head in the muck’ that surrounds it, systematically ignoring in the process uncomfortable economic occurrences that are unfolding on a daily basis.

Global crisis
Since January 25, I have been detailing in my Sunday Stabroek columns, the impact of fourteen major exogenous shocks/challenges, mostly externally-driven, which have rocked the Guyanese economy during 2008 and as a consequence damaged its prospects for 2009. The budget presented to the National Assembly on February 9 has devoted little attention to this. Hopefully, during the debates, opposition members would be able to force this topic to the top of the agenda.

Because of this stand, the budget makes two incredible claims. These are 1) that GDP grew by as much as 3.1 per cent and inflation by as little as 6.4 per cent during 2008 and 2) projects for 2009 GDP growth at 4.7 per cent and inflation at 5.2 per cent.
The growth rate of 3.1 per cent claimed for 2008 is double the average annual rate of increase (1.5 per cent) over the period 1998-2008. Indeed for four of the years during the past decade, annual real GDP growth has been negative. Further, the growth of 3.1 per cent for 2008 is about one-third that of the two previous years 2006-2007, implying that the economic shocks and challenges the country faced made no real difference. This is an unbelievable outcome.

We must bear in mind that the economic shocks/challenges in 2008, include the devastation of the floods and the near-collapse of the sugar industry during the second crop. Indeed, the sugar sector declined by 15 per cent during 2008. It was the same for forestry and worse for the diamond industry (37 per cent).

Prognosis for 2009

The element of make-believe economics is even more dramatically pronounced in the projection of Guyana's economic growth for 2009 at 4.7 per cent.

Worldwide, estimates of real GDP growth for 2009 have been declining, with each more recent estimate. The most recent estimate of global real GDP growth for 2009 is 0.5 per cent. This makes the budget projection of 4.7 per cent, embarrassing and ridiculous. Can it be that in Guyana the growth rate for 2009 can rise by more than 50 per cent above the growth rate for 2008!

Bear in mind that the analyses I have presented in these weekly columns since January 25 show that the global economic slowdown is getting worse – not better. Job losses, real GDP declines, investment flows, and consumer spending are trending down, everywhere. How therefore, could the performance of Guyana's very open economy defy this trend, when even the mighty Chinese and Indian economies cannot? As time passes, the expectation for the global economic turnaround is now being projected further and further into 2010!

Blatant as these make-believe elements of the budget appear, there are other very important ones. For the budget preparation, the Ministry of Finance refused to engage in the traditional consultations with stakeholders, such as the trade unions, private sector bodies and consumer organizations. Whatever point the ministry was seeking to make, we now know for certain that by refusing to consult this time, it has served to confirm the fact that previous consultations were not considered useful and therefore had nothing to offer to the analysis and proposals in the National Budget.

Delayed reaction

In any event, for those following my SN columns the question that should be now asked is: why did the government not make a concerted effort before to provide guidance to Guyanese on the potentially devastating effects of the global crisis that started at least four months ago?

In Caricom, where critics have been calling for urgent regional action, a regional task force was put together before the budget. The budget, with its make-believe elements, does not engage seriously or directly analyse the impact of the global financial crisis, credit crunch and economic recessions on Guyana.

This is a serious omission, particularly as efforts to deal with these exogenous occurrences in the rich developed economies are showing signs of economic nationalism, protectionism, beggar-thy-neighbour policies and inward-focused development. All of these imply neglect for the many priority items on the global agenda, which concern Guyana: climate change; nutrition and poverty; environmental sustainability; and, the achievement of the Millennium Development Goals.

EPA

A sad and perhaps poignant reminder of how 'make-believe' is the economics of the 2009 budget is its (non) treatment of the EPA (Cariforum-EC, Economic Partnership Agreement). Before, during, and after the government's signing of the EPA in October last year, the EPA dominated discussions on the prospects for Guyana's future economic development. Despite the National Consultation and the strong progressive public stance taken by the government on the EPA, this agreement fails to find mention in the first National Budget of the Guyana government, produced four months after its signing. If proof were needed that the budget was all about make-believe with scant attention paid to the serious day-to-day realities of the lives of Guyanese people, this surely provides it. To most Guyanese the prices they have to pay for goods and services relative to their incomes and wealth constitute the sharpest reminder of how their lives are faring. As we shall see in next week's column, the National Budget ignores the households who make up the nation and focuses on the government's accounts, as its priority consideration. I shall explore how this flawed development approach has hurt the people of Guyana.

Guyana and the wider world

By Dr Clive Thomas | March 1, 2009 in Features, Sunday

A cautionary tale: To be forewarned is to be forearmed

Recession proof!

The grimness of the global economic environment is so intense that those who shout "make-believe" economics will sooner, rather than later as the saying goes: "have to eat their words." Last week, (SN February 22) I expressed incredulity that the 2009 National Budget could be so much in the land of "make-believe" as to predict (target) a rate of growth of real GDP for this year at 4.7 per cent.

As I pointed out in that column, this rate of growth is nine times greater than the global average of 0.5 per cent, predicted by the World Bank for this year. More outrageously it is also more than 50 per cent greater than the official growth rate of real GDP in 2008 (3.1 per cent). I know of no country, which has projected such a rise in its growth rate for this year over last year. And, to make matters worse, this predicted growth rate is treble that achieved in Guyana as the annual average rate of growth during the decade (1998-2008).

Readers should bear in mind that the World Bank has predicted that, if the present global economic trajectory is maintained, developing countries as a group, could suffer a "lost decade" for economic growth, job creation, and improvement in living standards.

This is an important indicator of how serious are the global challenges facing Guyana.

The suggestion in the Budget that the Guyana economy is somehow recession-proof and insulated from the worsening global economic recession, financial crisis and credit squeeze, is not only implausible, it is also I believe a dangerous posture for the government to have adopted in framing the National Budget for 2009. This implausible prediction conjures the wrong impression. It sets up a worrying situation in which claims and expectations will grow, in the belief that more will be available this year than in the previous one. That indeed the threatening economic or financial challenges can be easily overcome.

Regional hardship: Why not Guyana?

To my mind a healthy dose of realism would have been far better. The priority now is to prepare all economic actors in Guyana for the serious challenges which lie ahead. Already, they are aware that the global crisis has brought considerable hardship to sister Caribbean territories, and they ask: so why not Guyana?

Trinidad and Tobago, although a huge beneficiary of the oil boom, has seen a massive fall in export earnings due to declines in the price of natural gas and oil way below the notional level of US$70 per barrel its government uses in preparing its own national budget. It has also had to deal with the collapse and bailout of the CL Financial Group.

The travel and tourism sectors have been very hard hit throughout the region, but moreso in those countries like The Bahamas, Jamaica, Antigua and Barbados, which are heavily dependent on these industries. Further, as I have continually warned in these columns, wealthy Guyanese and Caribbean folk, pension and trust funds holding significant external financial assets would have already been made worse off by the global crisis.

So too would have been those who participate in the organised crime that fuels a large portion of the underground economy. Both these legal and illegal groups usually channel and/or launder resources through regular financial connections between firms located in the Caribbean, and those in North America, Europe and Asia.

Financial scams and leverage

As the global crisis has progressively worsened, a number of frauds and scams are being unearthed. The two most recent are the Madoff US$50 billion Ponzi–like swindle and the Stanford Financial Group, US$8 billion fraud. The latter is located mainly in Antigua and the US. Both these frauds have directly affected Caricom and Guyanese nationals badly.

The recent press release by Hand-in-Hand Trust Corporation of Guyana confirms the local impact. However, the threat has been downplayed by the company. As with CLICO (Guyana) it is representing that there are small to minimal losses: “less than 10 percent of its assets.” However, until the company lets the public know how much it is leveraged, there is little comfort to be gained from this statistic. We have only this week seen where CLICO (Guyana) has ended up!

Additionally, the disaster of the CL Financial Group in Trinidad and Tobago will certainly have progressive negative reverberations throughout the Caricom region. I shall discuss in coming weeks more fully, aspects of this regional financial fallout and how it is likely to affect the financial sectors in Caricom and Guyana. As we shall see one of the key considerations to ponder as we consider the damage to local financial firms is the extent to which they are leveraged.

Hardship

The global crisis has, as I have reported, significantly affected the flow of remittances to Caricom. In Guyana this is particularly important, because of our heavy dependence on it, due to present low incomes and past low rates of growth. Commodity exports have also been badly affected. Thus the export of bauxite and alumina has been dramatically reduced in Jamaica. Despite its deliberate underplaying in Guyana the same is occurring as global demand for commodities fall with the global recession. Declines in commodity exports including, as we saw, natural gas and oil, have also impacted on Belize and Suriname. In addition, throughout Caricom, foreign aid, private investment inflows, as well as trade and other types of credit, have been virtually frozen.

Financial ‘runs’

If anyone had mistakenly believed that the Guyana economy is, or could be made insulated from the global crisis, the mounting evidence in recent weeks, if not days, should have disabused them of this idea. As we see with each passing hour, even global financial scandals are negatively impacting directly on Guyanese firms and individuals. The risk we face is that the Government of Guyana does not have the financial resources to facilitate depositors/investors if a substantial run takes place on local financial firms.

The present position adopted by the authorities that the threatened institutions are “small,” “insignificant” and “marginal” is unhelpful. Usually runs on financial firms are contagious and generate panic and extreme frenzied action, affecting both sound and unsound firms. No government in the world could afford to take ‘make-believe economics’ to the point of treating this threat lightly.

At this point, it is my fervent hope that the Regional Financial Action Task Force that I referred to in last week’s column, while pursuing preparedness at the regional level, might well rub-off on Guyana. This will be because of contingent commitments the authorities are going to be asked to give in order to frame coordinated regional responses.

Next week I shall continue from this point.

Guyana and the wider world

By Dr Clive Thomas | March 8, 2009 in Features, Sunday

Moral hazard and the Guyana regulatory meltdown

Moral hazard
When a sectoral regulatory authority, in this instance for the insurance sector, takes the position that regulatory intervention as prescribed by law would be prejudicial to a party that is involved in regulatory evasion and abuse, because such intervention "would have precipitated the demise of the company to the immediate detriment of policy holders," it means one of two ghastly things, both of which reveal a deeply flawed legal-regulatory-institutional oversight framework.
First, the regulatory provision is obviously flawed. And, if this is the case, then the regulatory authority has a bounden duty to secure the timely amendment of it. Secondly, such regulatory inaction encourages 'moral hazard.' That is, offending firms can operate with impunity because of the certainty that violation of the legal provision has no regulatory consequences. This is an appalling situation for Guyana to find itself in, at this time of collapse of global financial markets, due largely to weak regulation and oversight of past years.

Ponzi scheme
Readers should by now be fully aware that the galloping global financial crisis, credit crunch, and economic recession are taking a heavy toll on the financial sector of Caricom. In Guyana, the effective collapse of CLICO (Guyana), as well as the cloud hanging over Hand-in-Hand Trust Corporation, the New Building Society and the National Insurance Scheme, all have their origins in the global crisis, which has put Ponzi-like swindles under immense financial/economic stresses. The implosion of the CL Financial Group (Trinidad) and the wrecking of the Stanford Financial Group (Antigua) fall into this category.

With Ponzi schemes, as long as new investors are coming into the enterprise, all appears well. Better-than-average rewards are paid to early investors, which encourages new investors. An apparently virtuous cycle of new funds, high rates of return, and satisfied investors is set in motion. Once the inflow of new funds is halted, the fraudulent basis of these schemes becomes obvious. This inflow of funds was abruptly halted last September, as the global financial crisis emerged.

With the global crisis, most firms and wealthy individuals became less well-off. Some sought to recover their monies from these schemes. As their numbers grew, the inflow of new funds dried up, leading to firm failure. Only government intervention ('bailout') could prevent legal liquidation and/or administration by the courts of these firms. Investors lose. Immense personal tragedies ensue as life savings evaporate. But, it is the case that only governments with very deep pockets can afford bailouts.

Greed and panic

At this stage it is useful to recount that history has conclusively shown that the two worst behavioural traits to be found in capitalist financial markets are greed and panic. Greed is driven by the objective of making as large a profit as soon as possible, and to do so at all costs. Making a profit, therefore, justifies any means by which this is attained. With this outlook, illegality and immorality become the norm.

Not only individual investors and owner managed firms, but corporate firms through their agents (executives and managers) develop a culture of anything goes. In such circumstances, greed becomes systemic. Business ethics go by the board. Unthinkable excesses occur. Systematic evasion of the checks and balances institutionalised in regulatory and legal provisions becomes routinized. It is this greed that lay behind the Enron exposures of a few years ago and now the Madoff and Stanford frauds.
However, it is precisely to protect against such abuses caused by greed that countries have institutional-legal-regulatory and oversight frameworks.

Panic

Panic is as destructive as greed. The major difference is that greed is more insidious. It is, however, no less damaging. Panic stems from irrational behaviours aimed at protecting one's wealth and income. Like greed, this is true for individual investors, self-owned (mainly small and medium-sized) enterprises, as well as corporate firms, whose stockholders assign agents to run their business.
At this point, it should be recalled that the main benefit from capitalist markets lies in what economists term the 'animal spirits' or 'entrepreneurial drive' these markets produce in order to do things smarter, better, more efficiently, more productively, and therefore, more profitably. With such 'animal spirits' around, there is an inherent risk of panic.

Panic is both irrational and contagious. This can be clearly seen when something starts a panic reaction in a herd of animals and then how quickly this can spread like a contagion throughout the entire herd. Indeed, there are many instances where such panicked herds run headlong to their death, literally stampeding over the edges of cliffs. Again, the regulatory system should be designed to short-circuit such self-destructive actions.

'Credible'

The earlier references to moral hazard, panic, and greed, link to the equally fundamental consideration of how credible markets view governmental actions pertaining to the economy. All successfully functioning financial markets require clear laws, rules, regulations, and efficient institutions to ensure their effective implementation. Together, these comprise the overall regulatory and oversight framework.

I shall address this matter more fully in my next column. It is important, however, to note at this stage that for this framework to operate effectively government and its economic authorities have to be perceived as credible. If they are not, then when rules and regulations are issued, individuals and firms in the market will not act on them.

Next week I shall continue from this point by reflecting on the crisis of credibility, which the government and its economic functionaries face in Guyana today.

Guyana and the wider world

By Dr Clive Thomas | March 15, 2009 in Features, Sunday

A crisis of credibility

No easy remedy

Behind the sound and fury in public debates, self-serving government pronouncements, and the studied misdirections and deceptions in statements made by various economic authorities, readers should be reminded that presently we are witnessing the confused economic responses of a state, whose essential dynamic continues to be a vehicle for criminal enterprise. As such ostrich-like and make-believe public policies, the real risk of regulatory meltdown, and the crisis of credibility in regard to public policy are systemically integrated facets of the criminalized state operating at a time of unprecedented global economic crisis.

I have elaborated in previous Sunday Stabroek columns on the degeneration of the Guyana state into a vehicle for criminal endeavours. I will not repeat those discussions here, as my only concern is to remind readers that we are not faced with random and unrelated occurrences. As I shall show in the weeks to come, all are directly linked to the state's pathological condition. There is therefore, no easy remedy.

Risk

Last week, I argued that the country faces a real risk of regulatory meltdown, if the Commissioner of Insurance continues to feel compelled to act outside existing legal regulatory provisions. Pervious action (inaction) on her part has been rationalised on the ground of protecting "policy holders." This is absurd. When a regulator feels compelled to act in this manner, then clearly the regulatory provisions should be amended forthwith. If this does not happen, firms will know for the future that the particular regulatory provision is effectively inoperable, as was the case with CLICO. They could therefore, act accordingly without risk of penalty.

This is a situation of moral hazard, which all regulations have a duty to prevent.

Further, by identifying the interests of "policy holder" as the crucial consideration, the Commissioner fails to publicly address the fact that a key purpose of regulation is to contend with "trade-offs" among different stakeholders in the regulatory process. There is a professional obligation to show that, not only the interests of "policy holders" are being considered, but in this instance those of 1) "investors" in CLICO's depository-banking operations (disguised as insurance business) 2) the "general public," and 3) the integrity of the entire financial system. The reason why "policy holders" were prioritized should then be explained.

Due diligence

Based on recent events, there is the further issue of "due diligence." It does not augur well that the central bank let senior management of Hand-in-Hand Trust Corporation plead that several other depositors in the Stanford Financial Group got burnt, as if this were justification for their failure to do "due diligence." Effective banking regulation requires that the first priority must be that those who hold funds in trust are responsible for them, and must perform effective "due diligence."

The central bank should always stand ready to publicly refute utterances from financial managers, which introduce rationalisations for their failure to fulfil their bounden duty.

It would be a sad day for Guyana, if without regulatory rebuke, such pathetic claims continue to be publicly offered as solace to investors whose funds have been compromised, as in the Stanford Financial Group's Ponzi scheme.

From the perspective of the criminalized state, recent events betray a not surprising and continuing crisis of credibility. However, for financial markets to work effectively, public policy must be credible. In Guyana this is clearly not the case, and, we may therefore, ask: why?

For the remainder of this column I shall introduce some of the main factors, which have contributed to this sad state of affairs.

Official statistics: Missing, misleading and massaged

On several occasions in the past I have drawn attention to the weaknesses of official economic and financial statistics. This is a major factor in credibility. Statistics are routinely published late. Often, key data are either published very irregularly or not at all. Good examples are unemployment and poverty data, and estimates of the underground economy capital flight, and remittances. Moreover, all too frequently, when finally published, inadequate notation makes the meaning of several of these statistics unclear, as in the Appendix tables to the 2009 National Budget. Worst of all, many persons now believe that published official statistics are massaged to conform to the wishes of the administration.

Indeed these circumstances have been going on for decades. In the years of the PNC administration this was excused by claiming the "high cost" of data dissemination. Today, with the Internet, this particular excuse is no longer tenable.

Inconsistency and incoherence

A second factor behind the credibility crisis is the many revealed inconsistencies and incoherence of public policy. Consider a few examples thus:

1) Right up to last October (2008) when it was officially signed, the government had consistently focused on the detrimental consequences of the Cariforum-EC, Economic Partnership Agreement (EPA). Four months later, to the astonishment of many persons, the 2009 National Budget did not address the EPA. To say the least, this omission has confused economic actors about government's intent.

2) In similar vein the National Budget does not offer a serious discussion of the global financial crisis, credit crunch and economic recession. Yet, in the National Assembly debates, under intense pressure from Opposition parliamentarians and other public commentators, this ended up as perhaps the single most referenced topic in the debates!

3) When the Value Added Tax (VAT) was introduced many assurances were given that the tax would be "revenue neutral." Being a regressive tax, the government knew that the greater burden of the tax would fall on the poor. With a rate of 16 per cent, assurances were thus given that the VAT would not raise more revenue than that raised by the taxes it replaced. Yet, despite being almost daily confronted with this earlier promise, the government has continued to reap a bumper harvest from the regressive VAT tax, with no regard to "revenue neutrality."

4) Finally, we may further ask: does anyone in Guyana believe that a credible sugar "turn-around" plan can be produced in the one month the government has allotted for this task, when appointing the new Guysuco Board? Does anyone believe that after the long secular decline of the industry since the late 1960s when sugar output was about 370,000 tonnes that a production "turn-around" can be achieved in two years? Does anyone believe that a government can be sincere when predicting a growth rate for the economy this year, which is greater by more than one-half that of the previous year, (that is, 4.7 vs 3.1 per cent).

There are several other instances, which reveal that government's economic actions are not treated as credible. Next week I shall continue from this point, developing the idea that the crisis of credibility is a mirror-image of the risk of regulatory meltdown and the practice of make-believe economics. In turn, these derive from the more general condition of the state.

Guyana and the wider world

By Dr Clive Thomas | March 22, 2009 in Features, Sunday

The phantom economy and the crisis of credibility

Recap

In last Sunday Stabroek I had started a discussion on what I described as the "crisis of credibility" facing actions by the government and its functionaries on economic matters. This credibility gap runs throughout the entire gamut of economic matters, from review and analysis of the current situation and recent trends to the setting of targets, framing of policy proposals/programmes/projects, and the efficient execution of these.

I have so far considered two of the factors that I believe have contributed to this outcome. First, the glaring weaknesses of official statistics: late dissemination, hoarding, and the widely assumed 'massaging' of these in order to conform to the preferences of the administration. The second factor identified is the repeated instances of revealed inconsistency and incoherence in the execution of public policy. This latter has generated much confusion and distrust among a wide swathe of economic actors, including small and large businesses, waged-labour, the self-employed, and civil society organisations.

Criminal motivations

In this week's column I begin with introducing a third factor. This is the common knowledge or belief that a significant proportion of economic transactions in Guyana are inspired by criminal motivations. Among these are repeated instances of 1) general corruption and fraud 2) generating and distributing proceeds from organised crime 3) illegal capital flight 4) tax evasion and 5) foreign currency substitution (US dollar) in day-to-day transactions.

Such criminal motivations do raise doubts about the genuine nature of much of today's economic activity. They are also more broadly linked to the modus operandi of the criminalised state.

I reminded readers last week that there is a symbiotic relation between political elites and organised crime bosses, who together form the ruling cabal over events unfolding in the economic sphere. A state that has tolerated the extra-judicial execution of hundreds of young men, cannot be expected to pursue uncorrupted economic policies. This would seem to be too much of a contradiction to be at all possible.

Phantom economy

Let us examine the case of the underground economy, to see how this unfolds. The underground economy in Guyana emerged into prominence during the years of the PNC administration. Estimates that I had made showed that the underground economy was very large, ranging in size between 26 and 99 per cent of official GDP for the 1980s. This high estimate was independently confirmed in a study by Bennet published in the same journal (Social Economic Studies) in which my study appeared.

The 1980s underground economy was principally centred on 1) smuggling of goods banned by the PNC administration and 2) black markets for foreign currency (mainly the US dollar).

The latter arose because of legal restrictions on residents holding foreign exchange. As a consequence of these restrictions, a huge gap developed between the official exchange rate and the black market rate, providing a fertile outlet for illicit trading in foreign exchange.

With the liberalisation measures that came into place after 1989 under the ERP; and, in particular, the removal of foreign currency restrictions and the licensing of cambios, it was expected that the underground economy would have been effectively phased out.

It did not. At last estimate the underground economy averaged 47 per cent in Guyana for the 1990s up to 2000, according to a 2001 Working Paper published by the IMF (Faal, 2001). Along with other colleagues at the university's Institute of Development Studies (IDS), I am currently updating the estimates of the underground economy for the period 2001-2007, using the methodologies employed in the three previous studies by Thomas, Bennet and the IMF (Faal).

Although not yet complete, so far there are no surprises to the estimates we are obtaining. The dynamic of the underground economy, however, no longer revolves around the evasion and/or avoidance of government prohibitions. Today it centres on the proceeds of organised crime: narcotics trafficking, organised smuggling, and trafficking in persons, arms, ammunition, and high-priced items. This portion of the underground economy I had previously termed as the 'phantom economy.'

Estimated size
Assuming as I do that 1) the size of the underground economy remains more or less the same as the IMF estimate of 47 per cent and 2) between 25 and 75 per cent of this represents the proceeds of organised crime (phantom economy), then a considerable proportion of real and financial activities are controlled and/or contaminated with criminal endeavours. This estimate would range from about 12 to 35 per cent of Guyana's official GDP at market prices (or roughly 130 to 380 million US dollars).

This estimate would make it reasonable to assume that significant portions of transactions in the economy are guided by illegal and illicit motives. If so, this clearly distorts and complicates the operation of both private and public enterprises. Persons are therefore, forced to treat public policy with the proverbial grain of salt.

Other factors
There are other factors contributing to the present crisis of credibility. Some are also linked to criminality. Good examples of these are capital flight and money laundering. Both of these require systematic corruption and the undermining of due process in order to make them work. To date no serious efforts have been made to bring to the local courts

major cases on these matters, despite the widespread public assumption that there is an extensive presence of criminal pathologies in economic activity in Guyana.

Other factors are more benign. A good example is the role of remittances. Weak information on these, however, has created a significant blind spot in the economy. This makes it difficult to give credibility to official pronouncements and/or actions in regard to the economy.

Next week I shall turn to a discussion of the pervasive stench surrounding the CL Financial and Stanford Financial Groups, which has been around the region for some time now.

Guyana and the wider world

By Dr Clive Thomas | March 29, 2009 in Features, Sunday

The Stanford Financial Group: Scandals and scams

Smelling the stench

In recent years, individuals who have had their ears close to the ground in Caricom's financial, accounting, business, professional, and other expert circles, could not avoid being aware of the sordid doubts and deep misgivings swirling around corporate governance at the Stanford Financial Group. Even if some persons were inclined to give the group the benefit of the doubt, certainly there were enough misgivings around for prudent persons to exercise caution when dealing with the group.

If persons on their own could have gathered the need to exercise caution, then certainly reputable financial firms wanting to invest substantial sums in the group could have gathered a similar awareness of these misgivings. This could have been arrived at through various techniques, including selected interviews, surveys of expert opinion, and the hiring of financial investigators.

Stabroek News/London Daily Mail

The Stabroek News of March 15, 2009 has provided some results of an investigative report on the Stanford Group printed in the London Daily Mail. That report provided names, addresses, the sums of money involved, and other pertinent details in support of general concerns already being expressed in Caricom circles.

Consider some of these. First the claim that Stanford re-located his first bank, Stanford Incorporated from Montserrat to Antigua in 1985 because of clashes with British regulators, has been dispelled. In the SN article a much more sleazy escapade was indicated as being closer to the truth.

Second, that sleazy escapade revealed a portrait of Sir Allen Stanford, the group's principal, which differed vastly from the highly promoted image of a 'do-gooder' and philanthropist who came to Antigua's help at a time of need.

The SN article attributes to him "five outside wives." Without seeking to offer any moral judgement on this, it was common knowledge throughout Antigua that he was, as the article says, "a womaniser." The aspect of concern in this to a potential investor is that the same article continues to point out that the "common knowledge in the company was that all his women, like his employees were financially dependent on him and subjected to his controlling manner." To a prudent investor this reputation should immediately raise suspicions about the rectitude of financial information coming out of the group.

Third, the SN article also portrays several other disturbing deceitful actions. One is Stanford's attempt to forge lineage with the prestigious Stanford family, which established Stanford University, in California USA. That attempt was so heinous, the university was forced to file suit to protect for infringement of its logo.

As if this was not enough, a suit was filed in US courts and later settled last August, which provides ample details of his lifestyle. All this is public record in the US, and, any good search engine could generate information leading to these sources.

One would not expect that in practice, many individual investors would do their own due diligence in these areas. Certainly, however, an astute corporate investigative arm would seek out information on corporate governance at the institution in which it plans to place large sums.

Who are the suckers?
As a rule, Ponzi-type schemes such as that alleged by US authorities as operating at the Stanford Group, have been more successful in duping individual investors and privately owned and controlled companies than corporate organisations with professional staff capable of doing the investigation and financial modelling required to test the veracity of these schemes and discover how they earn their returns.

Individual investors are gullible. They are also vain about their 'investment savvy.' They are thus easily flattered by operators of such schemes in regard to their financial intelligence and business acumen. Worst of all, they are consumed by greed. This encourages them to downplay the risky nature of their action.

The old adage is very true. If the returns offered seem too good to be true, when compared to others in the market, then they are not true. Greater returns always embody greater risk. If an investor (Stanford Group) offers rates of return close to double what one can get from long established and well-known institutions, one must beware. We have seen this recently in the praise given by Dr Luncheon for the NIS returns from CLICO investments, when compared to others. The reason for the higher returns is that the risks are greater.

Firms are better suited to exercising caution. As a rule, they are expected not to be taken for a ride when they are holding other persons money in trust. For, if monies are lost through a financial swindle in an institution in which it invests then by definition it has failed to exercise proper due diligence.

In the case of Stanford Financial Group, as I have outlined above, suspicions have been around for some time now. Moreover, I would add, even if the trustee ignores these suspicions and as the saying goes, is taken in, once the financial crisis erupted last September, this should have led to an immediate pull-out from the firm and the search for safe investments, albeit at lower rates of returns. Trust companies cannot exercise greed, lose other people's money, and then claim they have practised 'due diligence.'

As we shall see next week in the discussion of the CL Financial Group, although no criminal charges have been laid against its principals so far, that group has also made the fundamental error of underestimating the negative impacts and the contagion precipitated by the eruption of the global financial crisis and credit crunch last September.

Conclusion: Due diligence

Readers should observe from the above that a due diligence exercise is not a simple standardized pro-forma exercise in balance sheet analysis. It involves also testing the credibility of the reported performance of an enterprise in every important dimension, including for financial institutions, its corporate governance as well as the character, probity, and confidence deposed by others in the principals of that institution.

The harsh truth is that if a corporate financial institution is swindled then due diligence could not have been adequately exercised.

Losses through financial swindle are different from losses incurred in ordinary trading.

That is buying and selling goods, services, and financial instruments on organised markets.

Guyana and the wider world

By Stabroek staff | April 5, 2009 in Featured, Features, Sunday

Invest at your peril: Why did the SEC fine the Stanford Group two years ago?

In this week's column I shall conclude the discussion on Stanford Financial Group started last week. Following that, over the next few weeks I shall undertake a review of the CL Financial Group, Trinidad and Tobago. As we shall see, like in the case of Stanford Financial Group, there are many important lessons to be learnt from the Guyana standpoint in that firm's financial meltdown.

Lessons to be learnt

From last week's discussion of the Stanford Financial Group readers should draw four very important lessons about investing in Caricom financial markets. First, investing individuals and firms should not be greedy and lose sight of the bigger picture. Higher returns on investments always translate to higher risks. This is an invariant rule of financial market behaviour. And, indeed we might also say that, when financial markets are undeveloped and the returns seem too good to be true, beware of a scam or swindle, as in all likelihood these lurk behind the investment.

Second, the practice of due diligence is not simply confined to a formulaic or pro-forma type balance sheet analysis. It requires serious investigation and scrutiny of the corporate culture of the financial firm you are planning to put your money into. Professionals for sure, but also ordinary individuals, should realise that prudence on their part, requires as much close attention to issues of corporate culture and governance, as to the balance sheet details. In other words, one needs to get behind the numbers put into the balance sheet to assess where the information comes from, as well as the reputation in the market of those providing it. To ignore this injunction in Caricom's financial markets certainly means putting your investment at peril.

Third, even if one were inclined to dismiss the many scandals surrounding the Stanford Financial Group over the years as mere rumour, the global financial crisis and credit crunch, which started last September were so fundamentally challenging to the region, as to warrant an immediate search for safer investment havens, even though these would have been less profitable.

Finally, to reiterate, it seems to me quite difficult for any careful observer of Caricom's finance and business to avoid being exposed to the many misgivings and doubts surrounding the Stanford Group. In my judgement, greed had to override caution for investors to persist with the group for long.

Not only Hand-in-Hand Trust

Hand-in-Hand Trust is the best known firm, which was taken in by the Stanford Group. However, there is a great likelihood that other firms and individuals in Guyana were also caught up in this scam. My experience has been one where credit unions, trade unions, acquaintances, friends and family had all inquired of me as to the soundness of investments held with the Stanford Financial Group (and CLICO also) after I had begun writing about the threatening nature of the global financial crisis since last September (SN September 25). In every instance, I had cautioned persons not to be greedy. I further advised an immediate pull-out from these investments. I was at great pains to point out what I am saying here that the higher returns would prove illusory if one lost the money that was invested.

The SEC fines the Stanford Group in 2007

Of course by last September the media had already reported that some time ago (2007), the United States Securities and Exchange Commission (the financial regulatory body in the US), had imposed a fine on the Stanford Group (Stanford International and Stanford Trust) for failure "to adequately state the risks involved in the sales of certificates of deposits." Any investor worth his or her salt could not seriously ignore the warning implied in the fine. To continue, despite this, to hold about US$4M in certificates of deposits (not to mention other sizable pension holdings) is to my mind unpardonable.

Panic in Antigua

The Stanford Group swindle hit Antigua the hardest, in the Caricom region. There was panic and a run on the Antigua bank operated by the Stanford Group. Fortunately, the Organisation of Eastern Caribbean States (OECS), which includes Antigua and Barbuda, as well as Dominica, Grenada, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines was able to take action to contain the crisis.

Under the coordination and guidance of the Eastern Caribbean Central Bank, a new company was formed to take over the Antigua bank operations of the Stanford Group. This is the Eastern Caribbean Amalgamated Financial Company. It is 40 per cent owned by Antigua. The remaining 60 per cent is held by four other financial firms in the OECS states. These are St Kitts and Nevis-Anguilla National Bank, National Bank of St Vincent and the Grenadines, National Bank of Dominica, and Eastern Caribbean Financial Holdings. All of them are either partly or wholly-owned by OECS governments.

Containing the disruption in Antigua is testimony to the significantly higher level of regional integration which has been achieved in the OECS when compared to Caricom, the parent body. The OECS operates a common monetary policy. It utilizes a common currency and practises "reserves pooling" across the seven OECS states. It has a common central bank that is responsible for these. It also practises cooperation in other areas, such as joint external missions. An OECS Secretariat exists to administer the affairs of the sub-grouping.

The resilience and prompt action exhibited by the OECS stand in contrast to that exhibited by Caricom to date, to cope with financial contagion in the larger region.

Next week I shall begin a review of the lessons to be learnt from the meltdown of the CL Financial Group (Trinidad).

Guyana and the wider world

By Dr Clive Thomas | April 12, 2009 in Features, Sunday

CL Financial Group: Meltdown and bailout

As promised last week, this week I begin a review of the CL Financial Group meltdown. I shall start with a broad description of the company structure and main operations just prior to the meltdown.

Structure and operations

The CL Financial Group is a holding company headquartered in Port of Spain. It had more than 70 subsidiaries and affiliated companies at the time of its meltdown. The group operates in over 32 countries. The principal regions are the Caribbean, Central and Latin America, North America, Europe and the Middle East (mainly Oman, Saudi Arabia and Qatar). In the Middle East, its main focus is on methanol plants, and plans were afoot at the time for more of these to be established in that region.

The assets of the CL Financial Group have been estimated at about US$15B. These include a wide range of operations in finance (mainly banking, brokerage, and insurance); energy and related products; real estate in several countries including the USA and Caribbean; manufacturing (mainly beverages); forestry and agriculture; and, a variety of services. Its largest subsidiary operation in Caricom is in Barbados (estimated at US$500M).

Readers would know by now of the fate of its CLICO financial operations in Caricom (The Bahamas, Belize, Guyana, Suriname and of course Trinidad and Tobago). These companies are all in dire straights. The Belize and Guyana operations are under judicial management. The one in The Bahamas is being liquidated. In Trinidad and Tobago the group is being administered through a Memorandum of Understanding (MOU) between the group and the Government of Trinidad and Tobago and its Central Bank.

The bailout/rescue package

Two months ago (January 30) several measures were announced at a joint press conference held by the Minister of Finance and Governor of the Central Bank of Trinidad and Tobago, along with the Chairman of the CL Financial Group − Lawrence Duprey. That press conference announced measures to govern the future operations of the CL Financial Group, in exchange for the bailout/rescue package that was to be provided.

Five key measures formed the basis of the MOU. Together, these were aimed at protecting the many depositors, policy-holders and creditors of the group and its subsidiaries and affiliates.

The first measure was the divestment to the Trinidad and Tobago Government of the CL Financial Group's shareholdings in Republic Bank, Caribbean Money Market Brokers and Methanol Holdings (Trinidad).

Second, in the event this was not enough to secure the revenue expended in the government's bailout of the group, the divestment of such other additional assets as was necessary to ensure this would take place.

Third, in light of the above two measures, the government committed to provide whatever additional bailout funds were needed to attain the objective of returning the group to a healthy state.

Fourth, the assets of CLICO Investment Bank which were held by the CL Financial Group, were to be transferred unencumbered to the state-owned First Citizens Bank of Trinidad and Tobago. The CLICO Investment Bank would be wound up and any additional assets would be assumed by the Central Bank of Trinidad and Tobago. Its banking licence was also revoked.

Finally, the government would appoint its own board of directors and management team to operate the assets it took over.

Different explanations

At the time of the press conference held on January 30, the Chairman of the CL Financial Group had offered four explanations as being responsible for the group's difficulties. One was the global credit crunch which had created a freeze on credit made available to it by German bankers. The second was the fall in energy and energy related prices. Third, was the fall in real estate prices. And finally, the Trinidad and Tobago parliament had recently legislated restrictions on inter-party transactions which adversely affected the group.

At the same press conference, the Governor of the Central Bank was at pains to point out that it was an unusually large number of depositors in the CL Financial Group's Trinidad and Tobago operations who had cashed in their holdings, which had precipitated the collapse of the company.

Among those seeking to withdraw was the state-owned National Gas Company. It sought to withdraw US$250M of its deposits and was only able to obtain US$14M. As the saying goes, this turned out to be perhaps the proverbial straw that broke the camel's back.

More surprises

At a subsequent press conference held in mid-February, the Governor of the Central Bank announced that the new board, management team, and CEO had been appointed as agreed to in the MOU. Regrettably, however, he declared that it appears as if "the financial position of CLICO was much worse than he had envisaged."

More pertinently, the CEO appointed by the Central Bank had on a separate occasion reported that he was failing to locate billions of dollars of assets held by affiliates of the group.

Cash cow

The Central Bank Governor further claimed that CLICO was a major source of cash for financing investments held by, and in the name of, the group's affiliated and subsidiary firms. CLICO, he said, has ended up as "guarantor for many of the group's assets most of which are heavily pledged." These pledges clearly limit the proceeds that can be realised through sale of the group's assets.

At the end of January 2009 CLICO Trinidad, had policy surrender requests on maturing obligations of TT$650M. It also had a "sizeable bank overdraft" and its bank balance was only TT$15M!

As we shall see in the coming weeks the explanations offered by the group's Chairman Lawrence Duprey for its troubles were, to say the least, odd. Before the group's troubles started he had revelled in its strength and boasted of the exemplary growth performance and dynamism of the group as captured in its related-parties business model. Furthermore, the Chairman also lauded the outstanding opportunities for the CL Group created by the very shocks and challenges occasioned by the global financial crisis, credit crunch and economic recessions, which he was then blaming.

Next week I shall explore this and other contradictions.

Guyana and the wider world

By Dr Clive Thomas | April 19, 2009 in Features, Sunday

Beware of boasting

At the press conference of January 30, held in Trinidad, and discussed in last week's column, Chairman Duprey of the CL Financial Group had indicated that the credit squeeze caused by German bankers refusing the company credit was a main reason for its troubles. Just prior to that, however, his statements in regard to the effects of the global economic crisis on the group's business were very boastful. Duprey claimed there were very good business opportunities arising from the global economic crisis.
Indeed he stated in newspaper reports "with the global economy in tatters and companies everywhere bracing for a reversal in fortunes" his group was poised to "take advantage of the world-wide financial crisis to snap up underpriced assets." There was clearly nothing to worry about.

He further promised that his brokerage subsidiary (Caribbean Money Market Brokers Ltd), would become the base for developing a world-wide network of brokerage firms. At the time the CL Financial Group had four brokerage firms located in the Caribbean, Central America, New York and London. The development of a global network, he suggested, would transform Port of Spain, Trinidad, into a major global financial centre and along with this the fortunes of the CL Financial Group would rapidly expand.

As he explained it, these developments were to be based on leveraging the network created by the brokerage firms centred on Caribbean Money Market Brokers Ltd.
At that time the Trinidad and Tobago Guardian had also reported that the brokerage houses already in the group controlled an asset value of US$1.3B. This was projected by Duprey to grow by a factor of about 2.3, to US$3B within five years.

That such grand schemes could fall apart so soon after, bringing disaster to the group rested on a very faulty assessment of the global economic crisis and the unprecedented risks which it posed.

At no stage of the crisis so far has it truly represented "a unique opportunity to acquire assets at greatly undervalued prices" as Chairman Duprey put it. This was dangerous rhetoric for a group whose very existence was predicated on continuing prosperity because of the business model it employed.

The moral of all this is to beware of boasting. Let your achievements speak for themselves. Idle boasting has been the ruin of so many.

Flawed business model
From what has been revealed so far, the group's business model was flawed in several major areas. First, as the Governor of the Trinidad and Tobago Central Bank pointed out, it was too reliant on inter-company related-party transactions. As he puts it: "excessive related-party transactions pose contagion risks."

When the economy is prospering and rapid growth is taking place, such a mode of operation looks good. A virtuous cycle is set in train. However, as soon as the economic environment turns sour, reliance on related-party transactions puts the entire group at risk. Contagion ensues and the virtuous cycle becomes vicious.

Second, the corporate culture of the group and its unorthodox styles of corporate governance were far too commandist, secretive and lacking in transparency. Modern ethical standards, befitting a global corporation are very different from those the group practised, as its meltdown across the region reveals.

Third, because of poor corporate governance, as the Governor of the Central Bank further pointed out, the group was only too willing to engage in excessive leveraging of assets. I would add to this also, regulatory arbitrage. There is now no doubt that the group routinely exploited regulatory loopholes within and across Caricom jurisdictions. Excessive leveraging of assets reduces the likely proceeds from disposal of these assets, if it becomes necessary.

Finally, through the practice of regulatory arbitrage the group operated deposit-taking schemes, premised on the payment of unusually higher interest rates than the financial markets would seem to be able to afford. As an example of this aggressive high interest strategy for acquiring funds, a relatively large value of highly liquid high-priced deposits flowed to its insurance subsidiary in Guyana, (CLICO).

This firm, however, was not registered to engage in deposit-taking as a commercial bank is entitled to do in Guyana.

It did so, however, with the knowledge of the regulatory authorities. It did not, however, come under either the regulatory jurisdiction of the Central Bank of Guyana, or the Commissioner of Insurance in regard to its deposit-taking schemes.

As soon as the global financial crisis erupted last September inflows of deposits faltered. And, worse, withdrawals soon began. This experience exposed the flawed business model.

In conclusion, two very important questions arise. One is, why did the Government of Trinidad and Tobago feel it necessary to provide a rescue package for such a firm? The second is, what is being done to correct the regulatory loopholes at the trans-Caricom level? In the former case the answer centres on the notion that the CL Financial Group is “too big to fail.” For the second question, I shall review efforts at the Caricom summit recently held in Belize to address these concerns. These matters will be treated in later columns.

Guyana and the wider world

By Dr Clive Thomas | April 26, 2009 in Features, Sunday

Is the CL Financial Group too big to fail?

Last week I had indicated that it was the stated conviction of the Trinidad and Tobago Government and its Central Bank Governor that the CL Financial Group was "too big to fail." This belief accounts for the far-reaching bailout and rescue package afforded to the firm. In this week's column I shall review the notion of 'too big to fail.'

I shall begin with some broad theoretical observations, as the notion of 'too big to fail' has acquired considerable reknown. It is now practised in several economies worldwide.

How capitalism works

In all profit-oriented, market-driven capitalist economies, two major forces are at work. One is the competitive drive. Individuals, firms, enterprises, and other suppliers of goods and services compete with each other for sales in those markets for goods and services, in which they are located. This competition produces profits for the winners and losses for those who do not succeed. As a rule, it is expected that those suppliers failing to make profit would be forced out of the market. Those who are profitable will remain.

In this competitive process, the dynamism, innovation, and growth potential of market capitalism are best exemplified. Those firms that lose and have to leave the market do so as part of the process of creative destruction. Their demise ensures that only the best and most efficient firms survive.

As this competitive process rules, paradoxically there are forces at work to undermine the competitive drive that sustains it. One of these is that successful firms tend to grow bigger and supply a larger share of the market. They become as a result, more concentrated. They seek to exploit the cost advantages of economies of large scale in production, distribution, and marketing. Additionally, ownership among suppliers becomes centralized in fewer and fewer hands.

As Marx pointed out centuries ago as this concentration and centralization occur, suppliers seek to exploit the profit potential, not of competition, but from their ability to exercise monopoly power in the market place. Monopoly power is the deliberate restriction of competition.

This contradiction reaches its epitome with the recent arrival in market-driven economies of firms, which are considered too big to fail. By this is meant that, if these firms fail, there would be systemic economic catastrophe. This in turn, would threaten the foundations of the market-driven capitalist system.

In this age of intense globalisation, several of these firms considered too big to fail, are integral elements of the global economy because of their transnational reach. If they failed, the entire global market-driven capitalist economy would be put at risk.

We may fairly ask: If firms become too big to fail, what happens to the process of creative destruction, which lies at the heart of the capitalist model of growth and development? There is no good answer to this contradiction. It does however reveal that, when all is said and done, in capitalist systems, capitalists dominate economic choices and outcomes.

How does the CL Financial Group compare?

The CL Financial Group is by no means a major global player. However, in the context of Trinidad and Tobago, and indeed Caricom, its collapse threatens to bring unprecedented harm, not only in the area of finance but in the real sectors: employment, government revenue, and so forth. The assets of the CL Financial Group in Trinidad and Tobago have been estimated at about one-quarter of that country's GDP. The CL Financial Group is easily the largest trans-Caricom financial enterprise. It has hundreds of thousands of policy-holders, depositors, investors, creditors, suppliers and employees across the region.

The Government of Trinidad and Tobago in collaboration with the country's Central Bank have been forced to put together an enormous rescue package or bailout for the group. However, the final cost of the bailout cannot be accurately assessed at this stage. The financial state of the group is too murky to arrive at sound measurement. Estimates indicate that this could be somewhere between 15-20 per cent of that country's budget.

In general we may say that the Trinidad and Tobago Government and Central Bank have treated the CL Financial Group as too big to fail, because they feel there are good reasons for this. The problems reach into the entire Caricom as troubles exist in every jurisdiction in which it is located. In The Bahamas, the CLICO operation is in the process of liquidation. In Belize and Guyana the operations are under judicial management. In Barbados the government has put in place a stand-by arrangement in event there is a run on the company which threatens its breakdown. The OECS states are in the process of putting together a stand-by arrangement also for the CLICO affiliate: British and American Insurance Company.

Is CLICO (Guyana) 'too big to fail'?

CLICO (Guyana) is not nearly as important to the Guyana economy as the CL Financial Group is to Trinidad and Tobago's. Indeed the government has repeatedly stated that at the end of 2008, CLICO deposit liabilities represented only three per cent of those held by the country's financial sector. The government has given the assurance to those that

CLICO (Guyana) owes that it will meet the liabilities of the company. Its intervention did not stem from the notion of being too big to fail. Other concerns clearly played a leading role in this instance, not least the political, social, and psychological damage that the unravelling of the company was doing to the Guyanese community.

Such non-economic considerations apply too, even when the dominant firm motive for a rescue package/bailout is because the firm is considered too big to fail. Indeed we might go further and say that the bigger the firm, the greater is its likely political, social, and psychological (cultural) hold on the life of the community. This hold cannot be discounted by governments when considering whether or not to put together a bailout/rescue package to contain the direct and indirect consequences of a financial firm's failure.

Guyana and the Wider World

By Dr Clive Thomas | May 3, 2009 in Features, Sunday

Caricom at sea: Coping with financial contagion

Next in importance to the damaging effects of the global economic crisis on Caricom's exports of goods and services, and possibly also public and private investment flows to the region, I predict that when the information is finally forthcoming, the contagion effects of the global crisis on the region's financial sector will be the most devastating. I make this prediction based on the fact that the contagion effects on the financial sector have already spilled over to the non-financial sectors of the real economy.

As we saw in earlier columns, the meltdown of the CL Financial and Stanford Financial Groups has had serious contagion effects in all Caricom states, except possibly two: Haiti and Jamaica. In The Bahamas, CLICO (Bahamas) is in the process of liquidation.

In Barbados the government has agreed to provide stand-by credit if needed for the local CLICO affiliates and is also helping to find buyers for CLICO's insurance policies. In Belize the CLICO affiliate is under "judicial management." The same is also true for Guyana where CLICO (Guyana) has a subsidiary operation in Suriname. In the Organization of Eastern Caribbean States (OECS), CLICO affiliates and in particular the British American Insurance Co have had serious contagion effects.

Too little too late!

The Stanford Financial Group meltdown has impacted mainly the OECS states. But in Guyana the Hand-In-Hand Trust Co has admitted to the compromise of its portfolio of assets held with the group. The company claims that this amount is about ten per cent of its total assets.

In light of all this, several readers have asked me to comment on how Caricom, as a regional integration movement, has responded to this meltdown given its dramatic trans-Caribbean impacts? In particular, they are asking for an assessment as to whether too little has been done and whether what has been done is too late. I shall respond to these queries in this and next week's Sunday Stabroek column.

Before I begin, I should clarify a couple of issues. One is that I shall be deliberately concentrating on regional Caricom-level responses. However, these are not neatly separated from national responses, particularly when the contagion effects of the meltdown of the two groups spill over from the financial sector to the real sectors of the Caricom member states. This occurs because the financial contagion has produced losses in national income and wealth, as investors, policy-holders, creditors, suppliers and employees in these two groups suffer losses in their portfolios. This in turn leads to reduced demand and as we noted in recent columns, the CL Financial Group alone accounts for hundreds of thousands of persons affected.

Another issue to be clarified is that because of the greater level of integration of the OECS, a sub-grouping within Caricom, the OECS-wide cooperation in dealing with the impacts of the meltdown is far greater than that in Caricom as a whole.

OECS responses

The OECS sub-grouping, which was established in 1981 has cooperated over the years in financial matters way beyond that in Caricom. The sub-grouping operates with a common Central Bank – the Eastern Caribbean Central Bank (ECCB). It has a unified currency, the EC dollar, and it pools the external reserves of the seven member states. It also cooperates strongly outside the area of finance. Thus for example it has a joint OECS Secretariat and has a common Eastern Caribbean Supreme Court. Further, it practises joint external representation in overseas missions.

The Eastern Caribbean Central Bank has steered, coordinated and guided action in the OECS to contain the fallout from the Stanford Financial Group. It took over the operations of the local bank of the group based in Antigua and established in its place the Eastern Caribbean Amalgamated Financial Company (ECAF). The funding for this company was capitalized by the Antigua government and the local commercial bank (40 per cent), and four other banks in the OECS region holding 60 per cent of the capital injected into the replacement firm.

Liquidity support fund

The coordination did not end there as the sub-grouping convened a forum to put in place plans to contain the spillovers effect from the collapsed CL Financial Group. At present that is taking the form of setting up a Liquidity Support Fund (LSF) to protect the OECS financial sector from contagion effects. The goal is to capitalize this fund with US$80M provided as follows: (1) the OECS states among them are to provide US$10M; (2) the Government of Trinidad and Tobago is expected to provide US$50M, this is to be diverted from the pre-existing Petroleum Fund that the Government of Trinidad and Tobago had allocated to Caricom based on projected revenues and prices for oil and natural gas; (3) the Government of Barbados is expected to provide US$5M, and (4) the remainder of the funding is expected to be provided by regional (mainly CDB) and international organizations.

While it would be premature to determine if the measures would be enough to contain the contagion effects of the meltdown of the CL Financial and Stanford Financial Groups, it does indicate a pro-active and region-wide engagement of the global financial crisis and credit crunch. Unfortunately, as we shall see next week, comparable action has not taken place at the parent body level of Caricom.

To begin with Caricom did not meet at its highest deliberative level to engage the global financial meltdown until March of this year – six months after the crisis first reared its ugly head. That meeting took place at the 20th Inter-Sessional Conference of Caricom Heads of Government held in Belize (March 20).

Next week I shall continue from this point but it is worth noting that several analysts argue that the OECS is ‘closing the barn door after the horse has bolted.’

[Guyana and the wider world]

By [Dr Clive Thomas] | May 10, 2009 in [Features], [Sunday]

The global economic crisis: A tipping point in regional integration

As I have tried to show in recent columns the meltdown of the CL Financial and Stanford Financial Groups has had serious damaging effects on the financial sector of most Caricom member states. In one way or another all states with the possible exceptions of Haiti and Jamaica have suffered from the meltdown. Indeed, it would be fair to say the meltdown constitutes a tipping point in the evolution of the negative impacts of the global financial crisis, credit crunch and economic recession on Caricom.

In last week's column I began my reply to readers' queries as to whether Caricom-wide responses to the meltdown were "too little too late." In that column I deliberately concentrated on responses from the seven member sub-grouping – the Organization of Eastern Caribbean States (OECS) to the meltdown. Although some critics consider their responses as representing the case of locking the stable door after the horses had bolted, on the whole my considered view is that the OECS responses have been far more in keeping with the challenges posed by the global economic situation than those of the parent body, Caricom, to date.

Without the shadow of a doubt the level of responses to the global financial crisis, credit crunch and economic recession within the Caricom hierarchy has not been commensurate with either the urgency or gravity of the economic situation which emerged at the end of August last year. Regrettably, it was not until March 20 of this year that the Conference of Caricom Heads of Government met in Belize on the occasion of the 20th Inter-Sessional Meeting of the conference that these matters were formally addressed at the level of what is Caricom's highest deliberative body.

Prior interventions

Prior to the summit there were three interventions of note. First, the Bureau of the Conference of Heads of Government received submissions from the Caricom Secretariat and the Caricom Committee of Central Bank Governors at the end of November 2008 on the global economic crisis and its implications for Caricom. These submissions were deliberated upon and the bureau endorsed and encouraged further study, monitoring, and contingency planning.

Second, shortly after that, on December 3, 2008, the Caribbean Development Bank convened a seminar to further study the economic and social implications of the crisis for the region. At that seminar there were officials from the international financial institutions (IFI) as well as regional officials.

Thirdly, on January 29, 2009, the Caricom Council for Finance and Planning met and among other matters reviewed the actions taken to that date by regional organizations and member states. The key decision was then taken to establish a Regional Financial Task Force to map the way forward for the region.

The task force was tasked with reporting by the end of March or early April 2009. It included, among others, the Caribbean Development Bank, the Caribbean Regional Negotiating Machinery, the University of the West Indies, regional labour and employers' organizations, the Caricom Committee of Central Bank Governors and of course the Caricom Secretariat.

As can be seen from this brief description none of these three interventions reflect the urgency and intensity of the challenges which were emerging in the region as the global economic crisis worsened. I believe that it took the dramatic meltdown of the CL Financial and Stanford Financial Groups to bring home the full scope of the negative impacts the crisis could have on the region, if coordinated and deliberate actions were not taken at the highest level of authority within Caricom.

What was agreed on in Belize?

Logically, it must be conceded that responses at the region-wide Caricom level cannot be truly separated from responses at the level of individual member states. Yet, for the purposes of this column these different levels of responses are treated as separate initiatives.

At the heads of government summit in Belize four broad regional responses emerged in relation to the financial meltdown of the CL Financial and Stanford Financial Groups. The most important of these has been agreement on regulatory reforms. A Collage of Regional Regulators has been formed and this was tasked with identifying the "full scope and location of the assets and liabilities of the CL Financial Group in Trinidad and Tobago."

Alongside this, another initiative is to establish as early as possible a regional regulatory framework. This is expected to oversee the region's non-banking financial institutions. The aim here is to rule out the scope for non-bank financial institutions to practise regulatory arbitrage by exploiting loopholes and weaknesses in regulatory jurisdictions across member states.

Thirdly, in order to reinforce this initiative, cross-border financial transactions among member states are to be prudently regulated. The existing free for all is to be terminated and replaced with strict prudential supervision.

The heavy focus on non-banking financial institutions reflects the confidence that the heads of government have in their central banks' abilities to effectively regulate the commercial banking institutions. There is an on-going Caricom Committee of Central Bank Governors that meets and coordinates functions and responsibilities at that level across the region. The heads of government have expressed full confidence in this body and its operations. The summit did however request that the committee prepare contingency plans to cope with any eventualities.

From reports the committee is examining several important matters including 1) the pooling of foreign reserve holdings of member states 2) the creation of a regional stabilization fund and 3) putting together proposals Caricom would introduce in the global effort to reform the global financial architecture and the management of key international financial institutions like the International Monetary Fund and the World Bank.

Taken together with the failure of the summit to arrive at a regional financial services agreement which has been under negotiation for years, these responses to the global economic crisis, now seven months old, are anaemic. It is as if it is not recognized that the financial meltdown represents a tipping point in the evolution of Caricom integration.

Guyana and the Wider World by Clive Thomas

By Stabroek staff | May 17, 2009 in Features, Sunday

After the EPA: Lessons to be learnt

There is a wise old adage: 'Ne-ver cry over spilt milk.' Like Humpty-Dum-pty, once it has spilt, it cannot be "put together again." Disregarding this wisdom, on the occasion of the 11th Special ACP Ministe-rial Conference on Sugar to be held here in Guyana on May 17-21, 2009 I shall address the ACP's forfeiting of the 1975 ACP-EC Sugar Protocol (SP) to the EPA Sugar Arrangements, not in the spirit of 'crying over spilt milk,' but to see what lessons can be learnt.

Georgetown Agreement

To remind readers, the ACP was established in Guyana through the Georgetown Agreement (1975). Its General Secretariat, based in Brussels, exercises responsibilities in a wide range of ACP-European Commission (EC) relations, including the SP (1975). The SP originated as a World War II (1939-1945) 'imposition' by Britain on its colonial possessions to ensure the continual flow of raw sugar to Britain's refiners as part of its war-time efforts against Nazi Germany.

Following further measures introduced at the end of the war, this evolved into the Commonwealth Sugar Agreement (CSA). The CSA was re-negotiated as a condition for Britain's entry into the EEC in 1973. It was extended to embrace its European partners and their Africa, Caribbean and Pacific colonial and ex-colonial sugar-producing possessions and became known as the ACP-EC Sugar Protocol (1975).

As an intergovernmental plurilateral commercial contract of indefinite duration, the SP was a stand alone agreement. This was admitted to in Protocol 3 of the First Lomé Convention, its three successors (Second, Third and Fourth), and the replacement Cotonou Agreement (2000).

The ACP's forfeiting of the SP was the end product of one of the most cynical and self-serving manoeuvres by the EC. Its execution was brilliant, as judged by the behaviour of Caribbean states with which I am familiar. Almost without exception they were far too willing to accept the EC's interpretation of what the SP constituted, as well as their own economic conditions, needs and priorities, in the face of startling evidence to the contrary. The SP was forfeited to facilitate the EC inspired, EPAs.

At present, and at the time of the forfeiture, no meaningful progress towards the multilateralisation of sugar as a commodity traded under the WTO had been achieved. One of the most important reasons for this failure is that, on a global scale, the cost of beet sugar production in the EU is several times the cost of cane sugar, produced on competitive farms. Because of this, the global rationality (efficiency) of the EU sugar industry (one of the world's largest) is deeply suspect.

Sugar Reform Programme

The EU's Sugar Reform Programme, which includes among other things ongoing changes in the methods of aiding (subsidising) sugar production, the management of production quotas, the mechanisms for regulating imports and exports of sugar, and as a consequence of all these, ACP-EC relations, have been portrayed by the EC as an effort to move in the direction of significantly liberalising the EU's sugar market. Right from the start in 2005-06, using data provided by the EC, I had shown in a study of the negotiating options for sugar that the outcome "after-Reform" was less liberalising than that with "no-Reform"! This was ignored. Instead the emphasis was lopsidedly placed on the lack of rationality (efficiency) in Caricom sugar production under the SP.

Beyond a shadow of doubt this is a real concern and it would have been decisive if one did not take into account what the SP represented. The SP was a commercial trade agreement between developing country cane sugar suppliers and developed country purchasers. It provided for commercial obligations by both parties. Thus the ACP was to supply assured annual quantities of sugar, subject to penalty, over an indefinite period, based on a price that assured "a reasonable return to a reasonably efficient producer of cane sugar (white or raw) in the objective conditions prevailing among the ACP suppliers." The EC obligated itself to purchase a quota of about 1.3 million tonnes "raw sugar equivalent" annually.

At the time the Protocol was signed the price for sugar on the world market was about 2½ times that paid under the Sugar Protocol and shortly after peaked at four times. Yet the ACP suppliers honoured their commercial obligation, as they appreciated the indefinite nature of this obligation and that sugar price trends might be reversed.

At that time there was no talk of the ACP subsidising Europe with cheap sugar. We may therefore ask: What has changed to allow Europe to get away with promoting so successfully the notion that the SP was a "preference arrangement" and not a commercial agreement? The main reason is that at the time the Protocol was signed into effect the world seemed to be facing the threat of permanent and imminent commodity shortages. This was the time of the Club of Rome and its doomsday forecasts of acute global resource scarcities. At present, however, largely through subsidisation, the EU's domestic sweetener supplies are assured for the foreseeable future. Its supply capacity exceeds its domestic demand. And of importance too, the threat of a world shortage of sugar no longer hangs over the market as it did in 1975.

Accompanying measures

If further proof of my argument was needed, consider that the accompanying measures tied to the EU's Sugar Reform Programme will generate, when fully totalled, benefits amounting to between US$8-10B annually, mainly to its beet farmers and processors. Annual benefits flowing to the ACP sugar suppliers will be about 1.4 to 1.7 per cent of this amount. The EU's 'Outermost Regions,' which are sugar-producing colonies, possessing similar production and structural conditions to many ACP states will also enjoy substantially greater benefits.

EC officials frequently boast to their ACP colleagues that they have no offensive interests in the restructuring of ACP-EC economic relations. There is little doubt, from the evidence, that the EU has had an offensive interest in scuttling the SP preparatory to completing the EPAs. This was achieved with such ease that future historians writing about these events will marvel that an asset of such potential value to the ACP was ceded so easily in exchange for "good faith" and "best endeavour" assurances from the EC. If ever a trade arrangement should have been taken to arbitration, the ACP-EU Sugar Protocol was one.

Of course other issues are involved, including 1) the EU's broader agricultural reform programme, 2) its production of non-sugar caloric sweeteners (isoglucose) 3) the position of least developed countries (LDCs) exporting sugar to the EC, in light of Europe's 'Everything But Arms' trade arrangement and 4) the challenge to the SP at the WTO.

Next week I shall extend the discussion to cover these considerations.

Guyana and the wider world

By Dr Clive Thomas | May 31, 2009 in Features, Sunday

By Dr Clive Thomas (E-mail address: cythomas@guyana.net.gy)

Political spin or reality: 'Signs of economic recovery around the corner'

One of the most hotly debated issues pertaining to the prevailing global economic crisis is whether all three of its components (financial crisis, credit crunch, and economic recession) are showing signs of tapering off, or at least not-worsening. Particular attention is placed on the economic recession in the rich industrial countries (known as the G8 group of countries) and the major emerging market countries (Brazil, China, and India). These countries concentrate the bulk of global purchasing power. And, because it accounts for about one-sixth of global GDP, the USA is the country whose performance receives the greatest global attention.

Readers should note that although it is important to know whether there are reliable signs that the worst of the economic crisis is over, it is equally critical to gauge how fast the recovery will be.

V, U or L

Economists usually represent the possibilities of economic recovery from a recession by the shape of three curves. First, the letter V. This indicates a steep decline, a relatively short-lived period in recession, and rapid recovery. Second, the letter U. Here there is also a steep decline, but the period at the bottom of the recession is more prolonged. After that, recovery is rapid. Third, an elongated L. Here the decline is also steep. However, when the bottom is reached the economy lingers in that state for a protracted period.

These three scenarios would have different social, political, environmental, and geo-strategic consequences for the world economy. One can safely expect that, the longer the crisis, the greater will be geo-strategic and political conflicts around the world. One can further expect a worsening of global environmental prospects as many of the current global initiatives on pollution, climate change, sea-level rise, and forest degradation and devastation would suffer from both reduced funding and political commitment to address them.

The same can be said for social and economic priorities such as improved health care and education; improved access to safety nets and social welfare; the elimination of poverty, hunger, and homelessness, the enhancement of global livelihoods; and, efforts to reduce discrimination based on race, ethnicity, religion, gender, and political beliefs. In sum we can safely predict: the longer the global economic recession, the greater is the likelihood of reverses in every major dimension of life.

Political spin

Much of the speculation/spin as to whether there are signs of a tapering-off or the situation not worsening comes from governments anxious to convince their constituents that their policy responses are succeeding. No matter what may be the ongoing circumstances of their lives, the worst is over. Next to this group, are operatives and players on the major financial and stock markets around the globe. Media personalities and anchors on business-oriented news outlets are major cheer-leaders.

Nowhere is this more readily seen than in the United States. Concerned about a possible political backlash from his consistent sobering portrayal of the disaster confronting the United States economy as a legacy of the previous eight years of ex-President Bush's administration, President Obama's administration has switched its spin over the past three months to a more hopeful portrayal of the US economy, hinting repeatedly at "positive signs" or "green shoots" amidst the worsening economic trends.

Stock and financial market players have spotted an opening in this new direction of political spin, for speculation and profit-taking. Indispensable as stock markets are as sources of funding for new economic ventures, trading in stocks and financial instruments is a casino-like operation (gambling) where stunning fortunes can be made, and lost. Within a matter of days if not hours, the major financial and stock markets in the United States have become for many the leading indicator of the progress of the economic recession. With fits and starts a rally has ensued. Over the past three months, successive gains were registered on stock markets. Although not taking share prices back to pre-crisis levels, this has softened losses in a number of portfolios.

President Obama's election campaign had focused on the fortunes of Main Street as the key indicator of the health of the economy, and repudiated Wall Street. Now, hourly and daily behaviour of prices on the Dow Jones, Nasdaq, and the S&P 500 markets have re-emerged as the main litmus test of the US's economic fortunes.

Danger and risk

There is great danger to this. A dominant fraction of the players and operatives in the stock market are, in essence, gamblers seeking as they say, to make a quick dollar. Their behaviour when buying and selling is very, very, loosely tied to the performance of the real economy, although they do not by any means ignore it. Their focus is on the short-run scope for making money and this may or may not be directly tied to the medium and long-term opportunities afforded by prospects in the real economy and the maintenance of economic fundamentals.

The rich industrial countries (G8) policy responses to the global economic crisis have been broadly of two types. One is for the government to act counter-cyclically. That is, to make expanded government expenditure take up the slack from reduced private investment, inventories, exports and consumer expenditure in the private sector. The second is to act pro-cyclically by having government reinforce market signals that a correction is needed. No dedicated effort is made to ease the burdens of the crisis and/or re-distribute its costs to those the market does not indicate should carry the burdens of adjustment.

Both these approaches however, entail future risk. Counter-cyclical measures run three major risks, namely: 1) inflation 2) protectionism and 3) inefficiency and corruption linked to too rapid expansion in public spending. Pro-cyclical measures run the risk of 1) prolonging the recession 2) ignoring its systemic roots and 3) promoting economic and social injustice in the distribution of the burdens of economic adjustment and recovery.

Next week I shall continue the discussion from this point.

Guyana and the wider world

By Dr Clive Thomas | June 7, 2009 in Features, Sunday

Hiccups on the road to economic recovery!

Last week's column referred to two important ongoing debates concerning the future course of the global economic crisis. One is, whether references to signs of recovery and the emergence of green shoots in current economic trends are pure political spin or are based on secure factual evidence. The other is, which is preferable of the two contrasting official policy responses to the crisis: counter-cyclical action, as exemplified in various stimulus packages, or pro-cyclical action, which permits private markets to run their courses and thus determine, through profit-loss rules, economic outcomes for businesses and consumers. As noted in last week's column, both policy stances carry huge economic, social, cultural, political, and environmental risks. My own preference, however, borne out of practical experiences in Guyana and the Caribbean is for the former policy stance.

Last week, I was at pains to point out that these debates have an important bearing on the eventual shape of the GDP growth curve over the recession and recovery period. I demonstrated this with reference to the three curves economists commonly use to describe the recession-recovery period, namely, curves shaped like the letters V, U and an elongated L. The distress caused by the recession varies according to the shape of the curve.

The W curve

There is a fourth curve that I did not mention, because of its rarity. Now I am not at all certain it would not be applicable in this instance. That curve is represented by the letter W. With this curve, the economy falls into steep decline, then it starts to recover, but not as rapidly as in the decline. Unfortunately, the recovery does not last long and soon the economy is plunged into another steep decline. Finally, there is a steep and lasting ascent out of the recession.

Political spin

On balance, it seems to me that political spin is trumping factual evidence. While it is true that over the past three months, stock market gains have created a sense that conditions if not getting better, are not-worsening, I believe one's judgment should be based on other economic indicators. I shall try to touch on some of these in this column. However, I do not wish to leave readers with the impression that stock market behaviour is totally unreliable. It is a useful supplementary gauge of business confidence and the outlook of firms. It can also impact on consumer confidence, since incessant media exposure of positive movements in stock market indices convey a 'good feel' that prospects are improving for all participants in the economy, not only buyers and sellers of stocks.

Other indicators

As the leading global player, I have four major concerns about the US economy. One is that, the housing crisis, which is at the epicentre of its economic woes is far from settled. Over the first quarter of this year (2009) housing prices fell by one-fifth. This is a sobering reminder that the problem, which is at the core of US economic distress, continues to worsen.

Second, the toxic assets (mortgages) associated with the bursting of the private housing market bubble have not disappeared. As a result the credit crunch (squeeze) has not dissipated into thin air. Until these toxic assets are effectively removed from the system, financial institutions will remain inherently unstable, no matter what are their share price valuations on stock markets.

Third, consumer spending in the US is still in decline. This is on account of both the huge wealth looses associated with the collapse of the private housing mortgage market and income losses due to job losses as a result of the economic recession. Further, the credit squeeze on consumers is resulting in a reduction of the number of credit card holders. As banks rein in on credit card issues and credit card debt, consumers continue to run away from the purchase of big-ticket items at this time. Fourth, there are presently massive reverses in several real sectors of the US economy. Nowhere is this more clearly seen than in the automobile sector. Not only is this sector the leading group in US manufacturing, but it also has huge negative multiplier effects arising from declines in 1) its purchases of supplier inputs (automobile parts and steel) 2) operations of its distributive outlets (dealerships) and 3) financing firms.

Several other sectors have also been adversely affected by what has already been so far, the worst economic recession to hit the US economy since the Great Depression of the 1930s. These include airline travel, hotels and accommodation, restaurants, consumer durables, and electronics.

Getting better: job losses

Because of political spin, US employment data for the month of April 2009 is being touted as concrete evidence of a reversal of economic fortunes. Is this an accurate portrayal? While it is true that the US Bureau of Labor Statistics has registered fewer jobs lost in April this year than the preceding month (March), the overall unemployment rate remained at an historic high of 8.9 per cent during April. Indeed, over 539,000 jobs were lost in April, bringing the total of persons who have lost jobs to 5.7 million, over the entire recession period, December 2007 to the end of April 2009 (16 months).

Four other related considerations are of note. One is that these data on employment/ unemployment do not include the sharp rise in part-time employment. That is, persons looking for full-time jobs who end up working part-time (underemployment). The second is that there is a significant variation in the unemployment rate across regions and groups in the US. For example, the rate is much higher for areas where automobile industries are located (particularly General Motors and Chrysler now in Chapter 11 bankruptcy), than elsewhere. Also, among African-Americans the unemployment rate is as high as 15 per cent. The rate for men at 10 per cent, is also higher than that for women.

A third related consideration is that the number of claimants for unemployment benefits continues to increase noticeably. And, finally, the ratio of job-seekers to existing vacancies is now as high as five to one (5:1).

Some commentators claim, these represent only ‘hiccups’ on the road to recovery! Is this true? Next week I shall take up the discussion from this point.

Guyana and the Wider World

By Stabroek staff | June 14, 2009 in Features, Sunday

by Clive Thomas

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Is economic recovery around the corner?

In my two previous SN columns I have been evaluating whether it is reasonable to claim that there are positive signs of early recovery from the global economic crisis. Or, whether such a claim is pure political spin. Those who posit signs of early economic recovery rely heavily on gains in the world's stock exchanges, particularly in the US. They say these indicate renewed investor confidence and an improved business outlook.

I had also referred in those columns to the 'political spin' being put on the decline in the reported number of jobs lost in the US for the month of April, compared to March. As I indicated, while April unemployment numbers declined, the US has lost a total of 5.7 million jobs over the previous 16 months of the economic recession. Moreover, its overall unemployment rate (8.9 per cent) remains exceptionally high and ignores the large number of underemployed part-time workers who want to work full-time, but cannot find jobs.

In any event, it is universally accepted that unemployment is a lagging indicator of economic recovery. Reduction in unemployment trails, rather than leads, economic recovery. Right now, the most optimistic forecasts do not see noticeable declines in the US unemployment rate before 2012. This is well after the most pessimistic forecast for economic recovery (2011).

Conditioning circumstances

Two basic conditioning circumstances will largely determine the duration and severity of the global economic crisis. These are: first and foremost, the global dimensions of the crisis, which I shall address in next week's column. Second, the fact that the epicentre of the crisis is the bursting of the private housing market bubble in the US. Because housing is the principal asset of households this has drastically reduced private consumption, which has been further reduced by income losses due to job losses.

Further, because of the global securitisation of these now toxic mortgage assets, the balance sheets of major financial institutions in the US and around the world have been seriously impaired.

The spectacular collapse and/or government bailout of a number of iconic financial firms like The American Insurance Group (AIG), Bear Stearns, Lehmann Bros, CitiGroup, Goldman Sachs and the Washington Mutual Bank, has not yet been rectified, despite the massive injections from the US Treasury by both the Bush and Obama administrations under the toxic assets relief program (TARP).

Federal Reserve Chairman: ‘Extraordinary times call for extraordinary measures’

By the start of the year, Ben Bernanke, Chairman of the US Federal Reserve System (central bank) had already superintended a significant decline in the target rate for overnight inter-bank loans. This was designed to ease the credit crunch (squeeze). The target rate, which stood at 5.25 per cent in August 2007 had been brought down to a range of 0 and 0.25 per cent by the end of 2008.

The Chairman had declared in early January, 2009: “Weak economic conditions are likely to warrant exceptionally low levels of funds rate for some time.” This action was not therefore undertaken as a short-term measure, but is anticipated to have considerable duration because of the “weak economic conditions.”

Later, on another occasion (February 2009) when he addressed the National Press Club, the Chairman made the famous remark: “Extraordinary times call for extraordinary measures.” As he explained it: “Responding to the very difficult economic and financial challenges we face, the Federal Reserve has gone beyond traditional monetary policy to develop new policy tools to address the dysfunctions in the nation’s credit markets.”

Traditionally, the Federal Reserve has pursued minimal intervention into the operations of the US economic and financial system. The Federal Reserve relied on demand and supply behaviour in private markets to resolve emerging imbalances in the US economy. It was the rule that Federal Reserve intervention distorted prices, costs, and therefore profit outcomes in private financial markets. Consequently, it was injurious to the system.

New tools

What are the “new tools” introduced by the Federal Reserve to get around the “dysfunctions” or “blockages” in the monetary transmission mechanism? The Federal Reserve traditionally operated through changes in the supply of money and/or the price of credit (interest rate). The new tools however 1) provide direct liquidity to borrowers in key credit markets 2) do the same for selected investors 3) purchase highly rated 3 month commercial paper 4) provide back-up liquidity for money market mutual funds and 5) establish funding for a Term Asset Backed Securities Loan Funding program (TALF).

Stress test for banks

Later, the US authorities designed stress tests for the 19 biggest banks in order to see how they would cope with severe systemic disorder. The concern behind this is that the largest banks are considered as too big to fail. That is, if any of them failed this would threaten not only the collapse of the entire US financial system, but in all likelihood that of the entire global system.

The results of these stress tests indicate some improvement in the present situation when compared to the last quarter of 2008. However, a majority of the banks needed further capital injections if they are to cope with a serious systemic breakdown of the US real economy.

Focus

So far I have focused on performance of the US economy, in assessing whether it is reasonable to assume that we are near the end of the global economic crisis. The reason for this is the US is not only the largest global economy, but its impact on global growth and trade is overwhelming,

Four decades ago, the statement was commonplace that when the US economy sneezes, the rest of the world catches a cold, or worse, pneumonia. At that time the share of external trade to its GDP was 10 per cent. Today, the US economy is far more open. The share of external trade to GDP has trebled, to 30 per cent. Every major grouping of the global economy is closely interlocked into the growth, trade and investment outcomes of the US economy. This is true for the other rich industrialised G8 countries, the major emerging markets of Brazil, India and China, as well as the varied assortment of poor developing countries.

Next week I shall begin to address the global aspects of the crisis emphasising the developing countries, to see whether reliable signs of economic recovery can be found.

Guyana and the wider world

By Dr Clive Thomas | June 21, 2009 in Features, Sunday

Is the global economy recovering?

Today the issue which seems to concern the international development community most (especially governments and international organisations) is whether it can be fairly claimed that generally, around the world, there are signs of recovery from the global economic crisis.

Previously, I have argued in these columns the global crisis has at its epicentre or core the bursting of the private housing market bubble in the United States. The securitized mortgage assets involved in this have turned toxic, impairing hundreds of major financial firms, not only in the US, but around the world. As a result, both a financial crisis and credit crunch (squeeze) of unprecedented magnitude and complexity are integral elements of the global economic crisis.

This sequence of events required me to first examine the US economy for signs of economic recovery or 'green shoots' among the dismal economic and financial trends being reported there. Furthermore, the global economy is so dependent on the performance of the US economy that, global economic recovery would be impossible without a US recovery leading the way.

In support of this observation, I had pointed out in earlier columns that in the late 1960s the share of the total value of US world trade in goods and services to its national output (GDP) was 10 per cent. Today this has risen to 30 per cent! There can be no doubt therefore that, the US economy is more open and interlocked with the global economy than it was four decades ago.

Trade and growth

During this period US trade grew more rapidly than its GDP. The world as a whole, however, also experienced the same phenomenal transformation. Today the global economy is far more open and more dependent on external trade in goods and services than ever before in its history. Increase in trade has become the foundation of economic growth in the vast majority of countries. Presently, it is estimated that three-quarters of the increase in global GDP is attributable to increases in global trade. Today, the total value of global trade in goods alone is estimated as US$14 trillion.

Indeed every year since 1982, the total volume of world trade has increased. For the first time since then, it is projected to decline this year. By way of comparison, world trade had increased by 8.5 per cent in 2006. While in 2007 this growth decreased, it remained high, at 6.0 per cent.

The latter part of 2007 up to mid-2008 witnessed a boom in the prices of major commodities traded on the world market. Readers would recall in that period, Guyana, like other developing countries, had to contend with extraordinary increases in the prices of imported food items and fuel. Food prices more than trebled and fuel prices peaked at US$147 per barrel. Several emergency measures were put in place around the world, in Caricom, and in Guyana to deal with what was termed the rising food and fuel prices crisis.

Commodity prices

The global economic crisis, particularly the economic recession aspects of this crisis, saw a collapse in commodity prices starting in the last quarter of 2008. In recent weeks these prices have been on the uptick, leading to the suggestion that global economic recovery is on the way. The truth is, however, that despite rising commodity prices, these are still quite some way off their peaks of less than a year ago. Thus oil prices, now ranging between US$67-72 per barrel, are in a price range which is less than half that of the peak of US$147 per barrel. Other commodity prices, which have risen by as much as two-thirds since December 2008, also remain at levels less than one-half that of their previous peaks.

The truth is many analysts believe, as I do, that it is not rising global demand which is behind the recent increases in commodity prices. If that were to be the case, this would indeed constitute a definite sign of economic recovery. Instead, commodity price changes are linked to speculation in the US dollar exchange rate. A weakening US dollar encourages speculative flight into commodities. Currency speculation, rather than rising global incomes, demand, and economic recovery, lies behind the recent increases in commodity prices.

The bottom line is that, if global trade is confidently expected to decline this year, then there can be no realistic expectation of economic recovery this year. The linkage between expanding global trade as the foundation of global economic prosperity has been unambiguously established.

Trade credit

The global economic crisis, as I have repeatedly noted in these columns, embraces a troika of occurrences, namely, a financial crisis, credit squeeze (crunch) and economic recession. The credit squeeze (crunch) has had a devastating impact on the trade of developing countries. Why is this the case?

Simply put, the credit squeeze (crunch) has produced a severe shortage of trade credit. Further, what credit remains available has been subject to an inordinate increase in its cost. In developing countries as a whole, 90 per cent of their trade (both importation and exportation) is dependent on accessing trade credit, according to World Trade Organization (WTO) estimates. The freezing of trade credit has caused their global trade to plummet, compounding the worsening effects of declining demand, due to the economic recession.

As a rule, the cost of letters of credit globally has trebled for major developing country importers like China and Brazil and doubled in others, like Pakistan and Argentina since the global economic crisis. Letters of credit are the primary financial instruments used in their global trade. Exporters depend on them to finance the production of their products before the receipt of payment from overseas purchasers. Importers also rely on them to purchase the items they need from sellers in other countries. Without such facilitation trade would be significantly curtailed, as it has been.

Next week I shall continue this discussion, expanding on the trade-related dimensions of the global economic crisis and its effects on developing countries.

[Guyana and the wider world]

By [Dr Clive Thomas] | June 28, 2009 in [Features], [Sunday]

Cesspools of financial chicanery and political intrigue

Because of spectacular developments in the ongoing scandals surrounding the CL Financial (Trinidad) and Stanford International (Antigua) Groups and the involvement of local Guyanese enterprises, I will postpone last week's promise to continue the discussion on whether there are reliable signs of recovery from the global economic crisis, as seen from the perspective of developing countries. Instead, I will treat with aspects of the ongoing financial scandals, because I am firmly convinced at this stage nothing less than an immediate public inquiry, buttressed by a forensic audit of the affected firms is required. This is to ensure that the ethics of professional responsibility, justice, and the rule of law prevail. It will also help Guyanese authorities to scientifically address two questions: What has befallen the country? And, why? From this many important lessons for future financial supervision could be learnt.

Financial and political chicanery

As time flows and more and more investigations are pursued by the media, law enforcement and regulatory agencies, the disclosures of financial chicanery and political culpability unfold. As regards the latter, media reports hint at the political-intelligence connections of the Stanford International Group in the US. The allegation that the CL Financial Group provided US$3 million to the PNM during the 2007 national elections in Trinidad and Tobago is being widely reported in the media.

In Guyana, the questions now swirling around payments to Premium Security Services Incorporated (PSSI) suggest a further obscene descent into the mess created by the collapse of CLICO (Guyana).

At this point, the only tidy conclusion to this affair would be a public enquiry, buttressed by a forensic audit of the local firms and their business transactions in Guyana and elsewhere, leading up to the present.

Stanford International Group

It is too early to tell whether any of the officers of the CL Financial Group and its Caricom affiliates will face prosecution over the meltdown of the Group. However, in the United States the Stanford International Group faces both civil claims and criminal indictments. According to the Associated Press, a twenty-one count criminal indictment has been handed down for "fraud, conspiracy and obstruction of justice." The US$7 billion dollars ponzi or pyramid scheme operated by the Stanford Group is accused of "bilking investors" in an orchestrated financial operation based in Antigua and Barbuda. The whole operation has been described as a "broad ruse to deceive investors, fabricate financial statements and hide fraud."

It has been estimated that over 50,000 investors are involved. This includes those in Guyana who have publicly professed that these investments appeared sound and were undertaken after “due diligence.” As I have previously pointed out in this column, given the sordid reputation of Sir Allen Stanford in sections of Caricom’s financial circles, it is difficult to see how thorough these assessments and evaluations of the Stanford Group could have been.

The Associated Press has also cited a Professor of forensic accounting in the Untied States (Western Kentucky University) as stating: “Any accountant who looked at [Stanford] reports would have told investors to be cautious.” As to the reports in question he also said: “Had the company’s estimated 50,000 investors looked past the glossy photographs and past Stanford’s buoyant optimism they might have been skeptical.” These Associated Press statements have been carried in thousands of media outlets around the world, including here in Guyana.

Investigation by the United States authorities has also revealed that despite the boast by the Stanford Group that it employed twenty exceptionally talented analysts, in fact, Sir Allen Stanford and one other person (his long time college buddy) were overseeing the US$7 billion portfolio of the company. These investments have been aptly termed a “black box,” as the only assets found so far apart from the personal properties held by Stanford (private jets, lavish homes and expensive artefacts) are some real estate and private equity held in companies, which do not trade on public stock exchanges.

Classic scam

This was indeed the classic scam. The firm had advertised that risk was minimal for the money investors placed in the company, while promising consistently over time exceptionally high returns. This was made possible, it claimed because of the exceptional investment skills in the possession of, and working for, the firm.

As I have urged readers in previous columns, higher returns in the market place always, and without exception, entail greater risk. No one could offer you returns for their CDs more than twice the going rates on these and assure you at the same time that there is no increased risk of losing your money. In the Stanford Group’s brochures, returns more than twice those on the S&P 500 had been routinely promised.

As the investigations have continued it has now been brought to the public’s notice that the Stanford Group worked in cohorts with the top regulator in Antigua and Barbuda, to the shock and horror of many. Leroy King, Head of Antigua and Barbuda’s Financial Services Regulatory Commission was “captured” and bribed to turn a blind eye to the Group’s transgressions. He has been indicted in the US courts as a co-conspirator. To quote the Securities and Exchange Commission: “This scheme was carefully orchestrated to make sure the true information never reached the light of day.” As I write this, the US authorities are in the process of securing his detention and formal extradition to the United States.

Guyana and the wider world

By Dr Clive Thomas | July 5, 2009 in Features, Sunday

The global economy: Economic recovery or more misery

Last week's column diverted to treat with the recent disclosures about the CL Financial and Stanford International Groups. This week I resume the discussion as to whether there is a credible basis for assuming that the worst of the global economic crisis is behind the developing countries and the global economy. I have argued so far that there is no compelling basis to assume that this is the case for the leading global economy – the United States. Although the global economy is far more differentiated than it was a few decades ago, the importance of the US in global output, trade and finance is so considerable and its contribution to the present global economic crisis so immense that recovery without it is most unlikely.

Writing for this column a year ago, globally, the dominant economic consideration was the explosive rise in food and fuel prices. Compared to 2005, by mid-2008 the price of wheat and corn, the two principal grains consumed globally, had trebled. The price of rice, which is the staple of choice for Guyanese, had risen five-fold. The price of oil was approaching US$150 per barrel. If readers recall this was a period of such considerable suffering around the globe that food riots, strikes, and conflicts were commonplace. Indeed, the World Bank had estimated that by mid-2008 about 130-155 million additional persons were pushed into poverty during the preceding year.
Heaping misery on misery

I remind readers of this, so they can put the present global economic crisis into its true perspective. The misery it is daily producing is being heaped on the misery that resulted from the food and fuel prices crisis of 2007-2008. Not surprisingly, therefore, the present global economic crisis has, by all accounts, already reached epic human and social proportions, especially for the many vulnerable residents of the developing world.

The World Bank, which is not known for scaremongering has warned that several of the Millennium Development Goals (MDGs) are at serious risk. Most of the eight globally agreed-to goals are in danger of not being met by 2015. In particular, it claims, this is true for the goals to 1) reduce hunger; 2) reduce child and maternal mortality; 3) secure educational improvement at the basic level; 4) ensure steady progress in combating HIV/AIDS, malaria and other major diseases; and, 5) halve extreme poverty by 2015 from its 1990 level.

Global data indicate that those who are chronically hungry have reached the staggering figure of over one billion persons. It is also estimated that for this year, 1.4 to 2.8 million children may die if the crisis persists. At present, the numbers in child mortality have been increasing at an annual rate of 200 to 400 thousand.

From all indications, therefore, the 130-155 million persons pushed into poverty because of the rising food and fuel prices crisis over 2007-08, could be added to substantially this year. The World Bank claims that based on the US$1 per day criterion, 45 million additional persons could enter the global poverty pool. And, based on the US$2 per day criterion, an additional 52 million persons could be added to this pool.

The macroeconomy

Macroeconomic projections seem to support this nightmare scenario. First, based on World Bank modelling of the global economy, it is predicted that most developing countries will be negatively impacted by the global economic crisis. The estimate is that 40 per cent of these countries are "highly exposed" to the negative effects of the global economic crisis; 50 per cent are "moderately exposed"; and only 10 per cent face "little risk."

Second, as the year has progressed, predictions about the effects of the global economic recession have worsened. Thus only three months ago (March, 2009) the World Bank had projected a 1.7 per cent contraction in the rate of growth of global GDP for this year. Its current projection (June, 2009) is for a 2.9 per cent decline this year (2009). Growth is projected at the quite modest rate of only 2 per cent for next year, down from the 2.3 per cent projected in March.

Of course there are other projections, some more pessimistic, others more optimistic. Thus the IMF is projecting a smaller global GDP contraction of 1.3 per cent this year and growth of 2.4 per cent for 2010. Generally, however, most projections indicate that at best the global economy is likely to have a "subdued recovery" during the second half of this year. Third, if as seems likely, global GDP does contract this year, this will be the first contraction in about six-and-a-half decades. It is also projected that world trade will decline by just under ten per cent this year. As we saw in previous columns global growth in GDP is very dependent on growth of trade.

Fourth, since the global economic crisis started in August 2008, industrial production in the developing industrial countries has fallen by an estimated 15 per cent. For the developing countries the fall is estimated at 10 per cent, if China is excluded.

Fifth, private capital flows to developing countries, which represented about 9 per cent of their GDP in 2007 were halved during 2008. This is projected to decline further this year by about 50 per cent.

Sixth, on average the prices of major commodities traded on global markets are about 35 per cent below the record levels attained during the rising food and fuel prices crisis last year. This has put a damper on inflationary pressures for many developing countries, but it also punishes commodity exporters like Belize, Guyana, Suriname, and Trinidad and Tobago in Caricom.

Finally, the developing countries as a group are expected to see their GDP growth rate decline from 5.9 per cent in 2008 to only 1.2 per cent in 2009. Compared to the rich industrialized developed states, they do better as the GDP of this group is expected to contract by 2.5 per cent this year.

Next week I shall continue the discussion from this point.

Guyana and the Wider World

By Dr Clive Thomas | July 12, 2009 in Features
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The global crisis requires global solutions

Observations

Last week's column sought to make three major observations about the ongoing global economic crisis. First, to be properly understood it should be located against the backdrop of the rising food and fuel prices crisis, which had engulfed the global economy (2007-08) – the year preceding the commencement of the present global crisis at the end of August 2008. Because of this, juxtaposition, the misery that is being generated by the present crisis is being heaped on that generated by the previous crisis of exploding food and fuel prices, which did not go away.

Second, arising from this, the present global economic crisis has been transformed into a deep and complex humanitarian, social, cultural and broad-based development crisis. I illustrated this last week with World Bank estimates, which show that a majority of the eight Millennium Development Goals (MDGs) are at grave risk of not being met by the target date of 2015.

The third observation is that global prosperity is heavily dependent on the rapid growth of global trade, even after acknowledging the tremendous contributions made by capital flows (both public and private) and remittance flows to poor countries. Every year for nearly three decades now, global trade in goods and services has grown in total value. Indeed as I pointed out in earlier columns, growth in global trade accounts for about three-quarters of the annual growth in global GDP.

Because of these three major observations and others made in earlier columns, the inescapable conclusion is that the resolution of the present global economic crisis requires global solutions. Solutions, which are not dimensioned globally, stand no chance of even solving the problems of those countries or regions to which they are specifically targeted. Fortunately, this seems to have been recognized by the leading players (governments, inter-governmental organisations and transnational enterprises) operating in the global economy.

G20 summits

The G20 summits held last November 2008 (Washington) and this year April 2009 (London) as well as those scheduled for later this year are testimony to the recognition of this truth.

The G20 comprises a group of 20 Finance Ministers and Central Bank Governors from 20 countries. These are the persons with portfolio and the highest level technical responsibilities to deal with the global crisis. They include 19 of the largest economies plus countries of the European Union, accounting for 85 per cent of global GDP, 80 per cent of global trade, and about two-third's of the world's population.

Also participating at the summits are the heads of the IMF, World Bank, the Development Committee of the IMF and World Bank, and the International Monetary and Financial Committee.

In November 2008 the then President George W. Bush, at the height of the eruption of the global economic crisis, requested a G20 meeting "to discuss and take corrective measures" to deal with the burgeoning crisis. Their initial declaration committed them to classic neo-liberal positions. Thus the leaders pledged commitments to 1) free market principles 2) the rule of law 3) respect for private property 4) open trade and investment 5) competitive markets and 6) "efficient and effectively regulated financial systems", as they combated the crisis.

At this year's London G20 summit they covered a wide ranging agenda that focused on (1) the coordination of actions to stimulate the global economy, after reviewing measures already taken (2) the reform of the global financial sector and systems and, (3) specifically, the reform of the three main international financial institutions (IFIs), namely, the World Bank, International Monetary Fund and the Financial Stability Forum.

Risk of 'business as usual'

While the G20 summits recognise the premium which needs to be paid to global coordination and to finding global solutions for what is truly a global problem, there is a grave risk that there will be 'business as usual' and only token or inadequate recognition of this will come out of the deliberations and proposals from the G20. To my mind it still remains an open question as to whether the horrendous financial crisis and credit crunch dimensions of the global economic crisis are fully appreciated. The economic recession data are more readily available and thus speak more clearly, as they are best illustrated in movements of widely available global national accounts data: consumption, investment, government activity, exports and imports of goods and services, incomes and value-added.

But as my friend and colleague (Sir Ronald Sanders) has reminded me in a private communication while the United States authorities have held "stress tests" for their banks, the Europeans and others have not. As a result we do not know what surprises might lie around the corner for the operations of non-American transnational financial firms and banks.

The decades preceding the eruption of the crisis have witnessed extraordinary financial successes and excesses. While there have been remarkable strides in financial innovation, equally, there has been an enormous deterioration in credit-risk management, and outlandish abuses in leveraging and securitization of assets. These latter have created fertile ground for systemic fraud and financial market manipulation. The worst examples of greed, manias, and panics have been revealed. All these have spread like a pandemic throughout global financial and credit markets, raising the notion of ‘contagion’ to exceptional levels of virulence.

Two features now complicate the global financial scene. One is that self-regulation by financial firms and businesses is no longer a credible option in which regulated markets will be allowed to operate. Everywhere, both nationally and at the global level, there are calls for new state-led regulatory regimes. But, there is, stiff resistance to this.

The other feature is that the true extent of the fragility of global and national financial systems cannot be fully gauged. The evidence does suggest, however, that this is immense. When taken in conjunction with the fact that the global economic recession has severely strained the capacities of most economies, particularly the developing ones, to ameliorate the negative impacts of the global crisis, we find in poor countries massive reversals in the social, economic and environmental gains of previous decades.

Next week I shall proceed from this proposition.

Guyana and the wider world

By Dr Clive Thomas | July 19, 2009 in Features, Sunday

Wanted: A United Nations Economic Security Council

G20 – leading the charge
In last week's column I argued that the global economic crisis had become very complex, involving immense human and social suffering, thereby constituting a grave threat to past global developmental efforts. As such, I argued for global solutions to the crisis. In my judgement no country or region can emerge from the crisis sustainably without a collective global effort.

I also pointed out that the world body coordinating the global response is the G20 group of countries. This grouping comprises finance ministers and governors of central banks of leading economies and representatives of international financial institutions (IFIs), with direct responsibility for global financial coordination, review, regulation, oversight, and the delivery of development financing. Finance ministers carry direct political portfolio responsibility for national efforts to address the crisis, while the central bank governors have the highest level of technical responsibility for this.
As a group, G20 countries represent 85 per cent of global GDP, 80 per cent of global trade, and 65 per cent of global population. While the G20 represents the technical/political face of global efforts at finding solutions to the crisis, the G8 constitutes the highest level of political authority for this. If the United Nations had an elected Economic Security Council for economic matters, as a counterpart to the present Security Council for political matters that body would have been the appropriate one to seek to resolve the global economic crisis. It does not, and by default the G8 group fills this void.

G8 group of countries
The G8 comprises eight industrialised countries: Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United States. It also includes the European Union (EU). Their heads of government meet annually, but sub-groupings, such as finance ministers, foreign ministers, and environment ministers meet more frequently.
Unlike most other international organisations, the G8 does not have a permanent secretariat. As an informal body its annual meetings rotate, and the host determines the agenda for the summit. By practice, other key countries are invited to ensure broader representation. The most regularly invited so far have been Brazil, China, India, Mexico and South Africa, to the extent that the G8 is sometimes called the G8+5.
Because annual summits are limited to a few days and there is no permanent secretariat, G8 meetings focus on broad policy issues, leaving implementation details to be filled in by the agencies it identifies.
While G8 countries represent the leading industrial economies, it is by no means as representative as the G20. It only includes about one-seventh of the world's population, although it represents more than two-thirds of global GDP, and the vast majority of

global industrial, military, and research and development capacity. It thus falls far short of a United Nations Economic Security Council, similar to the present Security Council of the UN.

Recent summit decisions
At the recent G8 Summit 40 nations and organisations attended. Four economic items dominated the agenda: the global economic crisis, food security, trade, and climate change. What was achieved?

Global crisis
Similar to these columns, the G8 Summit found it impossible to arrive at certainty as to where the global recession presently stands. It admitted that significant risks remain to global "economic and financial viability." While the various stimulus packages may be working, it was considered inappropriate to discuss the global economy post-stimulus packages, as recovery is by no means assured. This is important, as the global economy faces risks of inflation and runaway budget deficits in several countries, as they pursue efforts to stimulate national economies and provide safety nets through deficit financing (printing money). Already in the USA, the deficit has reached the trillion dollar mark – the highest level ever.

Food security
Because of the human and social fallout from the global economic crisis much attention was given to problems of hunger, malnutrition and poverty. To the surprise of many, the summit committed as much as US$20 billion over three years to agricultural investment in poor countries.
The emphasis on agricultural investment signifies a shift in focus away from the traditional "emergency food aid," which development experts had long criticised for not having a long-term sustainable focus. President Obama has been credited for much of the success in shifting focus to farm investment in poor countries and away from emergency food aid. He committed the US to providing US$3.5 billion towards this goal.

Trade
As I have repeatedly argued, growth in global trade is indispensable for global economic recovery. As future columns will argue, resumption of the stalled Doha Development Round of trade negotiations is a critical component of successful recovery. The summit recognised this and agreed to try to complete the trade negotiations in 2010. In pursuit of this, commitments were given towards convening a WTO Ministerial Conference, before September this year.

Climate change – 'Not enough'
There was an effort to do two things about climate change. One was to narrow differences over cuts in greenhouse gas emissions. The group aimed at a target of an 80 per cent cut by 2050. Neither India nor China agreed to their target of 50 per cent by 2050. Canada declared the goal "aspirational," and along with Russia said it could not meet the target. The second effort was to increase funding for low carbon technology. Both these efforts are geared towards a new United Nations climate change agreement,

emerging out of the scheduled December, Copenhagen UN Summit, to replace the Kyoto Protocol. The world press has reported UN Secretary General Ban Ki-moon as describing the progress on climate change at the G8 Summit, as “not enough.”

Oil

Finally, rising oil prices over the years 2007-2008 helped fuel the crisis of commodity price inflation in energy products and food items that immediately preceded the present global economic crisis. Concern was expressed that, although oil prices had not regained the peak of that period (US$150 per barrel), rising prices as the recovery developed could de-rail the recovery. Discussions on “regulating energy markets in order to reduce volatility” took place, but this did not make progress, as two major oil-exporting G8 countries: Canada and Russia deemed it technically infeasible.

Next week I shall look at the G8 Summit in light of the just concluded UN Conference on the global financial and economic crisis.

Guyana and the wider world

By Dr Clive Thomas | July 26, 2009 in Features, Sunday

Halting the runaway IMF and World Bank express

I have been arguing for weeks now that the present global economic crisis coming on top of the food and fuel crisis of 2007-2008, requires a global effort to resolve it. This position is now widely accepted among development experts and practitioners, as well as most international development agencies.


Dr Clive Thomas

The call that I also made for the United Nations to reform itself by creating an elective United Nations Economic Security Council, echoes similar calls made several decades ago in an effort by poor countries to restrain the rampant excesses of the Bretton Woods Twins: the IMF and World Bank.

At that earlier time, the brutal orthodoxy of the Wash-ington Consensus had devastated the economic, social and political environment of many developing countries, causing enormous human suffering, which should not be forgotten.

In the context of the Cold War struggles prevailing then between the ‘imperialist bloc’ led by the USA and the ‘socialist bloc’ led by the USSR, those calls for an elective United Nations Economic Security Council were part of the broader efforts of the Non-Aligned Movement to bring these two international financial institutions (IFIs) under the umbrella and jurisdiction of the United Nations. It was indeed argued that the original goal behind the establishment of the Bretton Woods twins in the post-World War years, was to make them part of the United Nations’ inter-governmental structure.

Aided and abetted

As we know, aided and abetted by the rich industrial nations, this did not happen. The goal, however, remained a latent hope for those developing countries that saw the IMF and World Bank as agents of external domination, acting on behalf of the rich industrialised states, which pre-eminently determined their management, policies, programmes, and practices.

The rich industrialised nations controlled the financing of these institutions and as the saying goes: ‘Who pays the piper, calls the tunes.’

Although the wishes of the rich industrialised nations have prevailed in the two IFIs, other groupings nevertheless emerged to frame the broader policy and resource availability of these institutions. In particular, the G20 and G8 previously discussed in recent Sunday Stabroek columns.

As we saw, the G20 represents the political and technical face to deal with global economic concerns. While the G8 represents a gathering of heads of government of the eight leading industrialised nations.

These two bodies have routinely and without public demurral from other governments, made pronouncements and gave policy instructions to the Bretton Woods twins. Indeed these two organisations are required to be in attendance at both G20 and G8 meetings!

It is from this perspective that the United Nations Conference on the Global Financial and Economic Crisis held a few weeks ago on June 24-26 will be considered in this and next week’s columns.

Symbolic value

However, before getting to the substance of what was discussed at the conference, matters of the utmost symbolic importance need to be addressed. First and foremost is that the conference should be seen as part of the continuing effort and aspiration of many concerned with the injustices being perpetrated in the global economy, to bring the regulation of the global financial system under the oversight authority of the United Nations.

Presently, the G8 and G20 groups routinely ‘decide’ on ‘global’ action affecting the IMF and the World Bank; for example, the recent announced decision to boost the resources of the IMF by US$500 billion. If the G8 and G20, both exclusive groups selected by the rich industrial nations, can routinely make and send onto these two bodies for global implementation, decisions affecting the entire world, surely the United Nations can do the same.

The United Nations, from the perspective of poor countries, is a more inclusive and universal body than the G8 or G20. Indeed, it has more global legitimacy to act in the name of the entire world than any other body. One might go further and say that, given the gravity of the crisis and its costs in terms of human pain and suffering, the United Nations has a duty to intervene, and not merely the right to so act.

The G192!

The United Nations General Assembly hosted the Conference on the Global Economic and Financial Crisis on June 24 to 26, 2009. Comprising as it does all 192 countries, in the course of the conference debates it came to be referred to as the G192.

All poor countries are represented in the General Assembly as of right. In stark contrast the G8 is an exclusive gathering of the rich. And the G20 includes the G8 and those other countries, which the G8 chooses to invite. There is no room in such a gathering for any of the many small vulnerable economies, like those of Caricom.

Such structural defects severely constrain the effectiveness of any global solutions they might promote. The paradox is, however, that predominantly, the human suffering occasioned by the global crisis has fallen on the poor countries. Thus as we saw the World Bank, predicts a nearly 6 per cent decline in the national income of poor countries this year. That is, falling from the originally projected 8.3 per cent for 2009 to 1.6 per cent.

Despite suffering the greatest damage by far under present global arrangements, poor countries have had the least say in shaping global responses to the crisis. The United Nations forum is therefore, crucial, as it is the only one in which poor countries are represented as of right.

Situating the discourse over the crisis in the General Assembly, consequently creates the possibility for asserting a more democratic and inclusive approach towards providing global solutions, without which as I have argued, the global financial and economic crisis cannot be sustainably resolved.

Next week I shall assess 1) whether the conference outcomes lived up to its expectations and 2) what this indicates for the evolving structure of global economic governance. In particular, does it give hope to the earlier calls for an elected United Nations Economic Security Council and all this implies for the re-assertion/establishment of the United Nations at the centre and as the highest level of authority, for addressing the present crisis and future ones.

Guyana and the wider world

By Dr Clive Thomas | August 2, 2009 in Features, Sunday

Poor countries and the United Nations role in the Global Economic Crisis

In last week's column (July 26) I had urged the importance of the symbolism for developing countries, which the United Nations Conference on the Global Financial and Economic Crisis held in New York, last June represented. This should not be under-appreciated, as by and large, the conference represented for these countries a continuation of their collective efforts to have the United Nations assert its hegemony over global economic and financial matters. Such an assertion, it is hoped, would redound to the benefit of poor countries.

Dr Clive Thomas

Despite the original intention at the time of the establishment of the Bretton Woods Twins (International Monetary Fund and World Bank) to have these institutions evolve, more or less, as part of the United Nations elaborate structure of inter-governmental bodies, this has not occurred. As I indicated, this has resulted largely because the rich industrialised nations did not want it to happen. Instead, the Bretton Woods institutions ended up as creatures and instrumentalities of the rich industrialized countries.

In the earlier context of the Cold War, this allowed them to exercise enormous control over the economic and financial policies of developing countries, and indirectly through this to exercise social and political control as well, which aided them in their struggles against the socialist bloc of countries.

In this week's column I shall turn my attention towards evaluating the results of the UN conference.
Strategic

Conference goals

Across the broad and varied range of developing countries there can be no doubt that there were numerous goals being pursued during the proceedings of the United Nations conference. With the benefit of hindsight and 20/20 vision, two of these now seem to form the strategic core, which drove the expectations of developing countries.

Undoubtedly, one was to keep a hard and continuous focus on mitigating and alleviating the devastating impact of the crisis on the poor and powerless. We have seen in recent columns that, as in the case of previous crises, a disproportionate share of the global pain and suffering has fallen on those countries least able to cope. Generally, developing countries have had the worst effects when measured by standard economic indicators, such as income, investment, export performance, unemployment, consumption, and social distress. At the same time, as a group, these countries have the least fiscal capacity to provide social protection and safety nets for their citizens.

The second strategic core goal, which seemed to have guided poor countries' participation was to avoid, if possible, the seemingly interminable periodic recurrence of crises, which has befallen market capitalism. This goal of avoiding repeated crises speaks to the systemic contradictions in the reproduction and growth of the global economy and its financial mechanisms. These lead to spurts in economic activity, followed by declines of varying intensity. This is not, I believe, correctable in the framework of market capitalism.

Policy options

In the context of these two strategic core goals, the poor countries appropriately advocated certain policy options to meet their situations. In the course of the conference deliberations it became clear that one of these was to ensure that the global system and its regulation secured for them adequate "policy space." By this is meant adequate opportunities for national policies to combat the crisis, which could be implemented without prejudice or sanction from the global community.

Several examples of this search for policy space were discussed at the conference. One was the right of poor countries to introduce trade measures, on a temporary basis, to cope with the fallout effects of the crisis on their import trade. It was suggested by several countries that this could be in the form of "temporary safeguards" that were made compatible with WTO rules.

Another example was the call for poor countries to be able to temporarily introduce capital controls in order to prevent capital flight and to have these sanctioned by the International Monetary Fund (IMF). There were, in addition, calls for a variety of other balance of payments safeguard measures and direct controls on foreign payments and receipts to be temporarily permitted as part of legitimate policy responses, and not be classified by the IMF as a return to foreign exchange rationing when they exercise their surveillance responsibilities over the global financial system.

Yet another example was the call for poor countries to be able introduce a standstill, for the duration of the crisis, to their foreign debt obligations to rich countries.

Other types of policy options focused on global measures to immediately address the negative economic impacts of the crisis on poor countries. In this regard a variety of measures were proposed.

For example there was the call to substantially boost the resources of the international financial institutions (IFIs) and other agencies so that they could afford cheap (no interest!) loans to poor countries in distress. Yet another is the expansion of the Special Drawing Rights at the IMF, (which is printing money globally), and distributing these in a manner that disproportionately benefits poor countries.

Conference results

From all reports the conference has had three definite outcomes. The first has been the production of its Outcome Document, which summarizes the discussions, decisions, and plan of actions at the General Assembly. An open-ended Working Group has been constituted to ensure follow-up action and continuity.

Second, the conference agreed that an ad hoc panel of experts would be established. The aim is for this body to provide independent technical expertise to the General Assembly to guide it through its future deliberations in the complex areas of global finance.

Third, there was agreement for the speedy implementation of a cooperative agreement between the United Nations and the Bretton Woods Twins (the IMF and World Bank).

As reported in the media, the Outcome Document “unambiguously recognizes” the right of developing countries facing severe hardships due to the crisis, to take appropriate measures to protect their citizens, as the rich countries have always done.

The open-ended Working Group established by the United Nations is expected to take follow up action on the many specific decisions and actions agreed to and adopted in the Outcome Document.

It is also requested to submit a report on the progress of its activities to the General Assembly before the end of the 64th Session, which is scheduled for September 2010.

Next week I shall conclude this discussion on the recent UN Conference on the Global Financial and Economic Crisis

Guyana and the Wider World

By Stabroek staff | August 9, 2009 in Features

By Clive Thomas

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Global conference on the economic crisis: Much ado about nothing?

I have urged repeatedly that, for poor countries, the symbolic importance of the recent United Nations Conference on the Global Financial and Economic Crisis should not be undervalued. The six-decades long march from the establishment of the Bretton Woods Twins (IMF and World Bank) to this conference has been one of immense pain and suffering for a large number of poor countries, which encountered economic difficulties and had to contend with these institutions during this period.

Allowing for the fact that some would claim that much of their economic difficulties could be traced to poor policies, bad politics and corruption, thereby being largely self-inflicted, the rigid and doctrinaire approaches of the IMF and World Bank in addressing these difficulties made matters immeasurably worse. I shall address this topic in later columns. My concern today is to simply evaluate the overall results of the conference from the perspective of poor countries.

As I previously indicated, the many aims and aspirations of the developing countries attending the conference could be distilled into two core strategic goals. One was to garner immediate international support for resources to flow to those poor countries suffering the worst negative impacts of the crisis. The other was to focus on removing those systemic features of globalisation, which were resulting in global crises of increasing frequency, complexity and ferocity.

As pointed out, there were three major outputs of the conference. One was its outcome document, which recorded the issues debated, the decisions taken, and the actions agreed on at the General Assembly. Linked to this was the conference establishment of an open-ended working group to follow-up on the matters recorded in the outcome document and report back to the General Assembly at its 64th Session, scheduled for September 2010.

The second output was the establishment of an ad hoc group of experts by the General Assembly. This group is expected to guide the UN through the complex arenas of global credit and finance. The hope is that the group would raise the technical capacity of the UN as it seeks to assert greater and greater collective oversight over the global financial system.

The final output was the decision to proceed with the coordination of the UN and the IFIs, especially the IMF and World Bank, which had hitherto acted completely independent, if not in disregard, of the UN.

Sampling country views

As readers know, as many as 192 countries participated in the June conference. It is therefore not practical for me to attempt to reproduce all the various country and regional positions at the conference. Based on media reports, I have singled out five summary country/regional opinions of the conference that are pertinent to Guyana and Caricom. First, based on a decision taken at the Heads of Government Conference held in Belize early this year (March), Jamaica spoke on behalf of members of Caricom to highlight two vital considerations. First, in much the same vein as this column has done, Jamaica stressed the importance of the fact that the United Nations had indeed convened the conference. This attests to its symbolic importance, which I have been stressing. Second, Jamaica claimed that the conference gave Caricom a voice in the global deliberations on the global crisis and by extension this voice was given to all small vulnerable economies. Without the conference, the voices of these countries would never have been considered internationally. Second, as it turned out the United States was the most unwilling participant at the conference. It was uncompromisingly against efforts to assign to the United Nations any role on decisions affecting the IFIs. It expressed satisfaction with what currently prevails and doubted that the open-ended working group had the expertise to deal with the many technical issues related to the international financial architecture. It poured scorn on claims that poor countries needed more "policy space," as I discussed it last week in these columns. It found it unhelpful for the UN, a political body, to talk about a structural framework for cooperation with the IFIs on technical issues such as debt, reserve currencies, and Special Drawing Rights for the IMF.

Third, Cuba was also very dissatisfied. Unlike the United States, however, it did not believe that the UN went too far. Instead, Cuba argued that the outcome document did not go far enough! Thus, Cuba claimed that the conference provided no new or additional resources for poor countries. Further, nothing was concretely done to provide for the "radical transformation" of the international financial architecture, which was so badly desired by all developing countries.

Fourth, surprisingly, the European Union underscored the symbolic importance of the conference. It however, felt that the outcome document was "ambitions," hinting at possible over-reach.

Finally, the President of the General Assembly was ecstatic about the conference and its results. He declared that the UN had been given a role on global financial and economic crisis and that through the open-ended working group, there should be no turning back on this. As he proclaimed: "The world has had the opportunity to hear the views of the G192. All members have had the chance to express their views… The G192 has now been established as a central forum for world economic and financial issues. This itself is a major achievement."

Summing up

When all is said and done, the question is: did the UN Conference on the Global Financial and Economic Crisis achieve much for the developing world and in particular small poor vulnerable economies like Guyana and Caricom? At this point, it is impossible to give a definite answer, as the benefits will have to flow out of the continued work of the open-ended working group established by the UN at the end of the conference. There is no doubt that the conference proceedings produced a rich and varied discourse on the systemic and other weaknesses of the processes of globalisation and the negative impacts these were having on poor countries. However, while the conference produced rich analysis of these defects and discussed a range of proposals to address them, it was short on concrete actions. This will have to be delivered by the working group as the conference itself failed to produce many concrete results.

Having said that, I would urge readers to not lightly discard the fact that this was undoubtedly the most important gathering of the UN to consider global economic matters! What this signifies for the future, we cannot accurately predict at this early stage.

Guyana and the Wider World

By Dr Clive Thomas | August 16, 2009 in Features, Sunday

Economic recovery: A long way to go for the poor

Pain and suffering

Over the past year, the full-blown effects of the global financial and economic crisis, have led to unprecedented pain and suffering across the global economy. The damage to poor countries has been particularly severe. As a result most experts say that a full-blown crisis of human development has emerged. This is a circumstance that every reader of these columns should be concerned about.

Dr Clive Thomas

In Guyana the authorities have tried their best to downplay the negative impacts of the crisis on our economy. A year ago they were boasting that the economic and financial systems of Guyana were well "insulated" from traumatic global shocks. Subsequent developments, including financial contagion, shortfalls in export earnings from goods and services (tourism), the shortage of trade credit, declines in remittances inflows, official development assistance and foreign direct investment (FDI) have exposed such idle boasting. Projecting a rate of growth for the overall economy in this year's National Budget, which is substantially in excess of that for 2008, I have already described as preposterous and likely to do more harm than good. The basic wisdom is that it never pays for authorities to exaggerate economic forecasts to the point of losing the public's respect and confidence.

In this regard Caricom's response has been hardly better. A year after the full-blown crisis emerged, there is still no coordinated Caricom response to it, despite the seemingly endless number of task forces that have been created to address the problem and produce solutions.

With this inaction, inertia has overtaken the process and one by one Caricom countries have reverted to the IMF and World Bank for assistance and solutions. In the same year that the United Nations Conference on the Global Financial and Economic Crisis has sought to reassert United Nations authority over the anti-development policies of these institutions, Caricom countries are lining up to seek their assistance!

Optimism!

Meanwhile, among economic analysts there is more and more talk of a possible turnaround of the US economy, beginning in the last quarter of this year. Providing there is no 'double-dip,' it is expected that most of 2010 will be a year of US recovery, and hopefully from this a start to global recovery as well.

Why this optimism? Several economic indicators seem to be tending in this direction. First, following on the stress tests held a few months ago, the US financial system seems to be stabilized. Financial stocks are leading the bold resurgence of stock markets, as stock market indexes achieve record highs for the crisis period. As I hinted in earlier articles, however, the European and Asian banks have not completed similar stress tests so we do not know what, if any, surprises many lie ahead of us.

Second, private housing prices have shown gains, albeit very modest, (0.5 per cent), for the first time in the crisis period. Third, while unemployment remains quite high, there was a modest decline from 9.5 per cent in June this year to 9.4 per cent in July. The numbers of jobs lost in July was about a quarter-of-a-million. A few months ago it was as high as three-quarters of a million.

Third, there has been an increase in inter-firm orders, although consumer confidence still remains weak. Much of this weakness is attributed to the slow turnaround in new jobs. In general the creation of jobs is always a lagging indicator during periods of economic recovery. Indeed, the historical data suggest that a growth in jobs does not begin to occur until the economy achieves a growth rate in the range of 2.5 to 3.0 per cent per annum.

Perhaps the most telling indicator of trends in the US economy is the behaviour of the real GDP growth rate over the past four quarters. This has displayed an unmistakeable V shape. In Q.1 the GDP fell by (-2.7 per cent). In Q2 this worsened to (-5.4 per cent). In Q3 it further worsened to (-6.7 per cent). And, by Q4 it was only (-0.1 per cent)!

The continued slide

US recovery, along with that in parts of Europe and Asia (mainly China and India) will no doubt help to stop the global slide. The truth is, however, that the poor countries of the developing world will continue to slide and suffer immensely from the negative impacts of the global crisis well after full recovery in the rich industrialised nations. This has always been the pattern. The poorest invariably fare the worst.

The question, which I hope to address starting next week in these Sunday columns is whether coming out of this unmitigated disaster for human development, any policy lessons can be drawn for Guyana and Caricom about coping with economic crises. I shall engage this issue from three basic standpoints. First, I ask the question: are there lessons to guide future fiscal and monetary responses to economic crisis?

Stimulus packages have gained worldwide currency but, as we shall come to see, these contrast starkly with the policy responses of poor countries in contending with past crises.

Second, global development agencies, as well as individual development practitioners have claimed highly successful innovations in framing and executing social safety nets and protection policies and programmes to cope with unexpected economic crises, social distress, and the situation of the poor. What are these innovations?

Third, as we have shown time and time again, the present performance of the global economy is inextricably linked to opportunities for expanding global trade. So much so, that the greatest fear in recent years has been that there would be a stampede to global protectionism. If this had happened, the global crisis would have deepened and the damage become incalculably greater. I shall explore in this regard, the general prospects for global trade and the World Trade Organisation (WTO) negotiations.

Next week I shall begin with a consideration of the first of these three questions.

Guyana and the Wider World

By Dr Clive Thomas | August 23, 2009 in Sunday

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Lesson #1: Stimulus packages: Facts and fables

Readers requests

Eight years ago the then SN editor-in-chief, David de Caires, ask-ed me to contribute a regular Sunday column under the general rubric: 'Guyana and the Wider World.' Over the years events in Guyana and the wider world have changed so rapidly and dramatically that it has demanded surprising nimbleness on my part just to keep writing about the most pressing issues of the day.

In this regard, last week I had promised to conclude my discussion of the present global crisis, with a discussion on the policy lessons that could be drawn for countries like Guyana in contending with future crises. I had identified three areas for future discussion: 1) the use of stimulus packages 2) innovations in social protection and welfare schemes designed to ease the distressing negative impacts of crises on the poor and powerless, and 3) the implications for future international trade policy and practice.

While several readers have indicated that they look forward to these articles, I have also been bombarded with requests from others to engage two different topics, immediately. One is that, in light of the revelations from the Roger Khan and Robert Simels cases, I should revisit my earlier analysis of the "criminalization of the state" advanced in these columns six years ago (March-September, 2003). The other is for me to evaluate the low carbon development strategy (LCDS).

The truth of the matter is that I had intended to treat with both topics after completing my examination of the crisis; the reason being that these are very contentious topics and will each occupy several Sunday columns. To divert now to deal with them, therefore, runs the risk that I might never get back to concluding the discussion of the global crisis. Most likely, other important matters will emerge during the next few weeks. This type of interruption has happened before, with a similar result.

Instead, what I shall do is to discuss the three topics listed above very summarily, and then proceed to address the two topics suggested by readers, in the order listed. I hope this compromise satisfies most readers, particularly as the two requested topics will be with us for a very long time.

Stimulus packages

The Obama administration's policy response to the US economic crisis has made the notion of a 'stimulus package' one of the most readily recognised economic policy measures globally. Basically, a stimulus package refers to efforts by government to stabilise/stimulate the economy, through manipulation of its overall level of spending and taxation. This differs from the other option available to the authorities of using monetary measures. These latter rely on central bank control of the supply of money and the price credit (interest rate) to influence private expenditure and income flows in the economy in order to stabilize/stimulate it.

Monetary and fiscal policies impact the economy through changes in: 1) domestic consumption and investment, as well as purchases of goods and services from abroad 2) the relative prices of goods and services in order to alter the pattern of resource allocation and 3) the distribution of income between groups, classes, and other categories of income recipients.

Stimulus packages aim at a net increase in government spending. Fundamentally this requires more government spending than government increases in taxation receipts. If the government spends more but finances all the increased spending from increases in taxation, there is no net expansionary impact on the level of economic activity. The combination described here is called budget neutral. There is no net stimulus effect.

Similarly, if government spending increases, but taxation increases by a greater amount, then the net effect on the level of economic activity is contractionary. We have to be careful therefore, always to assess both changes in government spending and revenue from taxation to determine if, and by how much, a stimulus package offers a real stimulus.

In other words, if the Guyana government plans to spend more to stimulate the economy because of the global crisis and at the same time intends to finance this spending from increases in VAT revenues, then the net effect on the level of economic activity from overall spending and taxing will be zero.

Unpardonable sin!

Stimulus packages that intend a net increase of government's overall activity in the economy are usually associated with deficit financing. To many conservative theorists, as we can observe from the criticisms of the Obama's stimulus packages in the US, expanding the public deficit is an unpardonable sin. The truth, however, is more complicated than this. While deficit financing expands government liabilities and so poses a number of risks, including the risk of inflation, we must remember not to look only at the government liabilities created by the stimulus. We have also to observe what assets are being created through the deficit spending. If the assets created improve productivity, growth, investment and employment, then the economy can 'afford' to increase its liabilities. Indeed, it is made better off because of it.

For most of the years since the late 1970s the mantra preached to poor developing countries has been that, if they were negatively impacted by global crisis, they should pursue contractionary fiscal policies. That is, the budget should operate in the direction indicated by the global crisis. That is, government policy should be pro-cyclical.

Counter-cyclical

Stimulus packages operate against this principle. They seek to stimulate the economy when the global impact is contractionary. Such policy stances are termed counter-cyclical. They seek to expand the influence of the government on the level of economic activity as a counter to recessionary/depressionary influences.

Domestically, recessionary/depressionary influences stem mainly from declines in exports, private consumption and investment expenditures, or a combination of all three. There are therefore two overriding binding constraints on stimulus packages. One is the balance on the country's external accounts.

All changes in the level of economic activity affect both exports and imports of goods and services. If there is a sizeable deficit between what the country receives from overseas sales as compared to what it spends on overseas products, then its ability to engage in a fiscal stimulus package is severely constrained.

By similar parity of reasoning, if the country planning a fiscal stimulus package already has a large unsustainable budgetary deficit and/or high levels of public indebtedness (external and/or internal) than its capacity to do this is also severely constrained. Unfortunately, the large majority of Caricom economies face one or both of these binding constraints. Their capacity to engage in meaningful stimulus packages is very limited.

In conclusion, we may say that, while the policy space now being afforded to poor countries to pursue countercyclical policies in today's world is to be welcomed, their capacity to effectively follow this course is severely constrained.

Next week I shall wrap up this discussion on facts and fables behind stimulus packages.

Guyana and the Wider World

By Dr Clive Thomas | August 30, 2009 in Features, Sunday

Making stimulus packages work

Expansionary impact

We saw last week that despite the high level of recognition readers have for stimulus packages as an economic policy tool, what it takes to make government spending a true stimulus is not widely recognised. Stimulus packages refer to the net expansionary impact of the government budget on the overall level of economic activity. This expansionary impact is determined by the net gap between changes in government spending and taxation/revenue receipts.

Of course, this is by no means the only economic impact of a government budget. Each and every item of government spending and taxation affects economic activity in one way or another. However, the stimulus effect of any given stimulus package depends on the net increase in government spending produced by the budget.

Readers may therefore, ask: If the government budget is in deficit in a given year, does this mean that its impact on the economy is by definition expansionary? In other words does a budget deficit mean the budget stimulates economic activity? The answer is no, it depends. Consider an example: the government ran a budget deficit of $500 million dollars last year. This year it also runs a budget deficit, but this is reduced to $100 million. Although there is still a budget deficit, this year its net effect on the economy is contractionary not expansionary. Why is this the case? In order to reduce the deficit by $400 million this year (from $500 million last year to $100 million this year) the government must either reduce spending, increase taxation or a combination of both to reduce the deficit by that amount.

Thus as a generalisation we may state: If the government is running budget deficits but reducing the size of these deficits, it is pursuing a contractionary path for the budget’s effect on the economy. A similar situation holds true if the budget is in surplus. If the trend is to reduce the size of the budget surplus, even though the budget continues to remain in surplus, the net effect on the economy is expansionary.

Finally, if the budget is kept in balance continuously, with expenditure changing in lock-step with revenue, then the overall budgetary impact on the economy is neutral. Once again I remind readers that the budget affects economic activity in a myriad of ways. What we are seeking to isolate here is the net impact of overall spending and taxation on the level of economic activity.

Keynes macroeconomics

This policy tool come into use in the 1930s and is based on the revolution in macroeconomic analysis made possible by the work of John Maynard Keynes. It was indeed first introduced into the US as a means of fighting the recession/depression of the 1930s. At that time, it was called 'pump-priming' the economy. This is based on the analogy of old fashioned pumps, which had to be 'primed' before they came into full operation.

There are five broad means of financing government spending. The most widely used and best known is taxation. Second, the government call sell or lease public assets. Good examples of this are the privatisations undertaken by Guyana governments over the past two decades. Third, government can withdraw money from any special reserve funds it creates. Some persons would say the Lotto Fund is a good example.

The last two means of financing government expenditure are the most controversial, largely because of their inflationary potential. These are to print money and borrow from the public. These two means apply in large measure to deficit spending. Printing money and issuing government securities or bonds are the most notorious means. Why? Not only are they potentially inflationary, but when the government borrows from the public several unfortunate results can occur.

One is, the government can crowd out private borrowers in the market as they compete with them for funds that savers are willing to lend. It is assumed that savers would feel safer lending to governments than the private sector. Another effect is that increased borrowing from the government can drive up interest rates. In turn, by increasing the cost of acquiring investment funds, this deters/impedes private investment in the economy. As we all know the cost of funding investment is a major determinant of the willingness/ability of enterprises/individuals to invest.

What works best

We can conclude this discussion by trying to establish what lessons can be learnt from the recent application of stimulus packages. Four general rules should guide us. First, the expansionary or stimulus effect of any given package depends on the amount of what economists term as 'idle resources' in the economy. When resources are idle, the economy is operating below its potential output. The increased demand created by the net increase in government spending will not be met by a shortage of productive factors able and willing to go to work. This has two important side consequences. One is that it reduces the likelihood of rising prices (inflation) in response to increased government spending. Further, it reduces the chances of government activity crowding out private sector activity, since there are resources available for everyone.

The second rule is that speed is essential for combating economic downturns. The data show that over the past six decades, recessions have lasted 11 months on average in the industrialised economies. The range has been 6 to 18 months, although the present global crisis may last longer. Also in particular industrialised economies, like Japan, recession has been much longer.

Third, stimulus packages should not result in badly conceived, designed, and executed government projects. These must all satisfy project evaluation (benefit-cost) criteria. The public expects and should get value for money. The difficulty here is that economists measure the value of a project's contribution to the economy (GDP) by its cost!

Finally, the more efficient, transparent, and participatory is the government, the more it is likely to successfully implement stimulus packages when faced with economic difficulties. Indeed this is a general rule, which applies to all state interventions in the economy.

This concludes the discussion on lessons to be learnt from the practice of stimulus packages.

Guyana and the wider world

By Stabroek staff | September 6, 2009 in Features, Sunday

Lesson #2: Fighting economic distress with cash

Recap

Dr Clive Thomas

There is no known way of successfully preventing future global economic crises and their negative impacts. Last week I concluded the discussion of the first lesson to be learnt from coping with the present crisis, which might help alleviate future ones. That lesson has to do with the use of stimulus packages as an economic policy tool. Three observations I made in that discussion are key to appreciating the tremendous significance of the second lesson, which I shall begin to discuss today.
First, as I earlier indicated, over the past few decades in poor countries, led by the IMF, World Bank, and neoliberal capitals of the rich industrialised countries, the accepted orthodoxy was to pursue pro-cyclical policies when facing economic shocks. These were aimed at making the country consume less and in particular to curtail government expenditure. Coming out of the present crisis there is now far greater acceptance by these same economic agencies that this old orthodoxy should go and poor countries, if they can, should do what rich governments have always done. That is, raise their spending when a global crisis negatively impacts their economy. Stimulus packages represent this new orientation towards counter-cyclical action.

Second, I also indicated that a stimulus package could only stimulate an economy if there was a net increase in the gap between government spending and taxation/receipts. Being in deficit, or for that matter surplus, was not enough to determine the expansionary impact of a budget. For this, it is necessary to compare the present budget position with that which immediately preceded it.

Thirdly, I advanced four guidelines for maximising the stimulative/expansionary effect of any stimulus package. These are 1) the presence of idle resources 2) that efficient cost-benefit (project evaluation) criteria should be applied to all government programmes/projects coming under the stimulus package 3) that the implementation of the stimulus package should be speedy and, 4) clean, transparent, accountable governance should prevail.

Provide cash to the poor
The second lesson, which I begin to address today examines the linkage between stimulus packages and the types and channels of government spending, which could prove most effective. A good example of this is the recent use in developed countries of government programmes to buy back from the public motorized vehicles which are ‘gas guzzlers,’ if they are traded in for new more efficient vehicles. Many readers would no doubt be aware of the recent ‘cash for clunkers’ scheme, as part of the Obama administration’s stimulus package aimed at stimulating spending on motor cars in the US.

At the time of our great flood in 2005, I had suggested in these columns that the best way to compensate those poor households badly affected by the floods would be to give them cash grants. These could have been given in exchange for their local contributions to mitigating the flood effects in the environs and local communities, in which they were based.

During that period a few development agencies and experts were already touting such conditional cash grants/transfers as an innovative way to cope with sudden catastrophic distress befalling poor households. As events have since turned out such conditional cash transfers have been found to be among the most successful innovations in the practice of social protection schemes for the poorest of the poor in poor countries.

Conditional cash transfers are conceived as part of welfare programmes contingent on agreed actions by the recipient of these transfers. To illustrate what I mean, a government or community faced with serious school absences, late arrivals, and drop-outs from poor households could offer cash payments to those household heads that ensure their children attend school on time for an agreed-to number of days in order to qualify for the cash payment.

Over the years, the ‘conditional’ element of the transfer has changed both its nature and terminology. Today, the politically correct term is ‘co-responsibility.’ Operators of these schemes wish to distance themselves from the neo-liberal connotation of conditionalities attached to the IMF and World Bank adjustment programmes. For them a social compact between the provider of cash and the beneficiaries has been made.
As we shall see, when I come to evaluate the pros and cons of these mechanisms next week, a significant number of developing countries, particularly in Latin America and the Caribbean (LAC) and Africa have these schemes. The best known examples in the LAC region are the pioneering ones in Brazil and Mexico. In Caricom there is one: the Programme of Advancement Through Health and Education (PATH), which is administered through the Jamaican government’s Ministry of Labour and Social Security.

Practice in rich vs poor countries
In rich industrialized countries when events force a downturn in the economy and persons are thrown out of work, all the jobless are automatically entitled to compensation payments over a stipulated period. In many rich countries these have been extended during the present global economic crisis as part of stimulus packages. Generally, however, income transfers to the jobless are standard budgetary practice. These payments

can therefore be characterized as built-in automatic stabilizers for the economy. They increase when the economy declines and sheds jobs. The jobless, by having access to these unemployment benefits are given a boost to their incomes. This helps to maintain spending since empirical studies show that as a rule consumers' expenditure is mainly a function of the income they receive.

In poor countries there are usually no automatic unemployment benefits provided by the state. The great hope is that these conditional cash (income) transfers, if they become an integral part of government's expenditure at times of economic downturn in poor countries, could similarly act as automatic stabilizers, which are biased to protecting the incomes of the poorest of the poor.

Next week I shall continue this discussion by seeking to evaluate the pros and cons of conditional cash transfers as an innovative social welfare (protection) mechanism. During the current crisis they have been revealed to have had exceptional salience.

Guyana and the wider world

By Dr Clive Thomas | September 13, 2009 in Features, Sunday

Using cash to manage risk for the poorest of the poor

Within the international economic community there is a growing consensus that the worst is over. It is expected that the global economy will turn the corner and come out of the financial and economic crisis during 2010. Already it is projected that the vast majority of G20 countries (17 at the last count) might see their recessions end in the final quarter of this year. It is against this background of growing optimism and hope that I have been exploring the crucial lessons, which should be learnt from recent global experiences in coping with this exceedingly complex and painful crisis that burst on us a year ago.

Dr Clive Thomas

Last week I discussed conditional cash transfers as an innovative way of providing social protection to the poor, and in particular, the poorest of the poor at times of grave developmental setbacks. This, I suggested, is the second main lesson, which should be learnt from the present crisis that would be immensely useful in dealing with future crises. This week I shall discuss more fully some of the pros and cons of this new developmental mechanism.

Pros and cons

The truth is for a large number of persons (perhaps a majority) giving cash to poor people as a means of fighting poverty makes them pause. The reason for this is partly due to the fact that they have negative images of ‘dependency’ developing from cash handouts to poor people. Additionally, some persons actually believe that they know better than poor persons how to spend money on their behalf and so would prefer to spend it for them. While there may be other reasons for hesitation, I suspect these two are primary.

The cash payments in these schemes, however, recognise that poor people have a better sense of what they need and would choose to spend money on. The issue is, therefore, to tie their receipt of cash payments to a definite set of poverty reducing actions. This is the basis for making these payments conditional.

Some examples from actual practice should help to clarify the principles at work. Requiring households/individuals who take cash payments to attend medical clinics for vaccinations, pre- and post-natal care, HIV/AIDS testing, dental and opthamalogical testing for infants and children improve the health status of these persons. By building up their human capital, they are better endowed to fight poverty on their own behalf and that of the community/country in which they live. Other types of requirements often include fulfilling targets connected to education, the environment, community networking and so forth.

Because of these features conditional cash transfers focus on fighting poverty both in the short term (through immediate cash payments to relieve growing distress) and the long term (building up human, social, and cultural capital). Recognition of these features is responsible for much of the success and acclaim attributed to this mechanism as a new tool for fighting economic difficulties. It has become a key part of expenditure in several developing countries' stimulus packages.

There are many other features of this mechanism, which are of particular merit at times of economic recession. One of these is that lacking assets and access to readily available credit, cash transfers to poor people are quickly translated into expenditure on consumption and/or investment items. This is precisely what is needed at times of economic recession, a quick increase in spending.

Irony

The irony is that for decades traditional social safety nets in rich countries have operated on the same principle when persons made jobless are given cash (unemployment) benefits to help tide them over difficult times. As I pointed out last week, these payments are approvingly described as 'automatic stabilizers' in the economy. They rise, when the economy fails to grow and sustain job expansion. In similar fashion these conditional cash transfers, depending on their magnitude and coverage, have the potential to become pro-poor stabilizers in developing countries. They should rise when economic downturns put pressures on the poor, and in particular the poorest of the poor.

Experience has shown that to be successful conditional cash transfers require very careful targeting. By this is meant clear determination of the communities where they apply, their duration, those who qualify, the criteria for establishing qualification for the schemes, requirements for exiting the schemes, and their financing. Such careful targeting places a heavy premium on the regular compilation of social and economic data and the extensive use of surveys backed up with up-to-the-minute socio-economic databases.

Evaluations

What do evaluations of conditional cash transfer schemes show? A recent World Bank Evaluation Panel found a strong correlation between these schemes and reduced poverty rates. At the same time they found that the two most widely used conditional requirements, health and education, did not reveal marked improvements in the health status or educational achievement of beneficiaries. However, this mixed result has been contradicted in other evaluations, which found considerable success.

Thus the United Nations review of the World Social Situation (2005) found success in reducing inter-generational transmission of poverty and a growing popularity for these schemes. Specific impact evaluations of these schemes in Latin America and Africa also show very good results. Several schemes were found to have a positive impact on education, health, and nutrition outcomes for the poor; the last moreso, when the schemes are linked to the availability of cheap food supplements.

These evaluations have also found that these schemes do not encourage dependency. That is, they have no negative impact on labour supply from poor communities. Indeed, large scale conditional cash transfer programmes have helped to reduce income and wealth inequality. In particular, they have narrowed poverty gaps and reduced the severity of poverty by being disproportionately helpful to the poorest of the poor. In this sense these schemes have overall helped poor households to manage risk and cope with the distress heaped on them by the global crisis.

Next week I shall conclude this discussion, before turning to the third and final lesson to be learnt from this crisis, which is, how to address global trade as part of national solutions.

Guyana and the wider world

By Dr Clive Thomas | September 20, 2009 in Features, Sunday

Political will and consensus: Making conditional cash transfers work

Four concerns

In last week's consideration of the pros and cons of conditional cash transfers as a policy tool for fighting the increased poverty and economic distress occasioned by the global economic crisis I referred to the results of impact evaluations of these schemes, mainly in Africa and Latin America. Overall, these showed that there were strong positive short-term and long-term impacts on the poor. The positive short-term impacts flowed from the early injection of cash directly into the hands of poor people. This placed them in a better position to manage the negative impacts and short-term risks associated with the crisis.

The positive long-term impacts on poverty varied with the type of conditional actions required of individuals and/or households in order to qualify for cash support under the programme. In the instances of health, education and nutritional conditional requirements, there has been noticeable improvements in the health status, educational and training levels, and nutritional outcomes for the designated beneficiaries.

Added to this, there have been other significant benefits. For example, the impact of increased spending by poor persons from their cash transfers, at a time of economic recession, has injected buoyancy into the economy. Similarly, their impact on the distribution of income and assets has helped to reduce gaps between the poor and non-poor.

Taking these positive results into account, I would still argue that four crucial concerns need to be properly addressed if these schemes are to be consistently fruitful and beneficial to the poor. First, these schemes need to be carefully structured with clear unambiguous criteria and rules for establishing the eligibility of beneficiaries, the attainment of exit requirements for those no longer eligible, and the fulfilment of the conditional undertakings attached to the schemes. This places a strong premium on professional and competent staff, best-practice socio-economic databases, and capability in social engineering. Second, the schemes have to be independently monitored, reviewed and verified (MRV). This requires a strong regulatory/oversight/ institutional framework so as to ensure good governance in these schemes and that there are clear and severe penalties against persons engaged in illicit activities.

Corruption

Third, without doubt in my mind, the single biggest threat to these schemes is corruption. This can come from two sources. One is from those individuals/households who try to 'smart' the arrangements. Usually this is attempted through falsifying the required socio-economic information and concealment of sources of income and access to assets. The other type of corruption is usually politically-inspired. This can take many forms, but the most typical are nepotism, political cronyism and 'pork-barrelling.'

Indeed corruption of these types is possible in all social protection schemes. In-kind benefit schemes have multiple opportunities for abuse. For example 1) in the purchase of items 2) in the storage/inventorising of items 3) in their distribution and 4) in their ultimate consumption. Conditional cash transfers have one major opportunity for wrongdoing. That is when the cash-payments are made. However these can be done through bank transfers to beneficiaries (debit cards!). Of course there is also the opportunity arising from the requirement of beneficiaries to fulfil their undertakings.

Finally, a major difficulty facing these schemes is the sustainability of their financing. In developing countries the two main sources of funding are 1) the international community and 2) national governments. In the United States, (New York) where Mayor Bloomberg pioneered a conditional cash transfer mechanism for poor New Yorkers, the scheme was funded with private donations.

In developing countries, the international community has not committed to long-term indefinite funding. When the resources they offer to these schemes come to an end, the schemes are usually terminated. When national governments finance them, they too often see the schemes as bringing them political benefits so that their duration is limited to the political/election cycle. These two considerations have led to some worthwhile schemes being terminated. Because of this I would argue very strongly that the success of conditional transfer programmes depend on both the political will of governments to start them, and a broad political consensus in support of them, as enduring aspects of the efforts to fight poverty and underdevelopment.

T&T's experience

In conclusion it would be useful to note briefly the Trinidad and Tobago Targeted Conditional Cash Transfer Programme (TCCTP) as it has been named, because it has been the subject of much attention by the regional media over the past two weeks.

This conditional cash transfer programme started in 2007 just prior to that country's general elections. The suspicion is that it might have had more to do with political cronyism and electioneering than with a genuine concern for the plight of vulnerable persons and households in that country. Be that as it may, over US$10 million (G$2 billion) has already been allocated to the programme. The programme provides cash to the vulnerable through debit cards issued to them, for the purchase of basic food items.

A recent independent review of the programme noted that about 20 per cent of the persons receiving the cash payments (about 6,000) did not qualify as they did not meet the criteria for receiving support.

To its credit the government has vowed to remove these persons from the programme. However, it has also pledged additional funding for the programme in this year's national budget, to the tune of 35 per cent, on account of the pressures already created by the global economic crisis and its local impacts.

This episode clearly reveals both the strengths and weaknesses of conditional cash transfers as a tool for fighting poverty and increased economic distress in the Caricom region.

Next week I turn to the third and final lesson to be learnt from experiences in dealing with the present global crisis. That is, where does trade fit in with national efforts to stimulate the economy and help the poor at times of global economic crisis.

Guyana and the wider world

By Dr Clive Thomas | September 27, 2009 in Features, Sunday

Global recovery and downside risks

Optimism

The current state of the global economic crisis, one year after the financial meltdown of last September (2008), provides a crucial backdrop for consideration of the third, and final lesson to be learnt from global and national efforts to cope with economic recession, financial crisis and the credit squeeze. The first lesson, which I have already covered is the role of stimulus packages as a response mechanism. This was followed by an assessment of conditional cash transfers to the poor, as an innovative and successful way to tackle the economic misery, which much of the world has been enduring for the past year.

The third G20 Summit since the crisis began a year ago took place in Pittsburg USA last week. Many economic analysts and governments are quite optimistic that for most countries recovery is already taking place and that the crisis will turn the corner in the next quarter of this year. And, that further, 2010 will see the resumption of widespread growth. For some countries this will occur early in 2010 and for others much later. However, already, it is being confidently asserted that 17 out of the G20 countries will be definitely out of the woods by the end of this year.

Such optimism at the recent G20 Summit contrasts with the dour expectations at the time of the summit in November last year and the April one earlier this year. Readers, however, should be reminded that there are several downside risks attached to this optimistic outlook. And, as I shall argue one of them (trade policy) is the subject of the third lesson to be learnt from the crisis that I shall be considering.

Downside risks

What are the downside risks to the expectation of economic recovery? The first downside risk is that the recession may take a 'double-dip.' That is, the global economy as a whole or some major economies including the US will slide back into economic recession despite the early signs of recovery at this stage. The question we need to ask is whether there is a real risk of this happening?

In my opinion there is. The basic reason for this is that leading the early signs of recovery is the massive stimulus spending of governments. If this is curtailed because of signs of recovery, there is a real risk that if alternative spending from consumers, investors or foreigners on exports, does not take up the slack caused by the decline in stimulus spending, then reduced aggregate demand could re-introduce a recession-type situation.

The second downside risk is also directly related to this. As we have seen, in the United States where the global recession is centred, the decline in consumer demand is a major contributory factor. The same is true for other rich developed economies. It remains true that US consumer spending alone accounts for about one-sixth of total global aggregate expenditure! This is indeed a whopping amount and so it must be a matter of great concern that US consumption expenditure still remains flat and shows no real signs of rebounding.

The third downside risk is that in the US unemployment continues to rise, even though at a reduced rate. As readers know, job growth tends to lag economic growth in the economic recovery phase. Despite this there remains a real concern because the unemployment situation is largely responsible for reduced consumption spending. As I have pointed out several times in these Sunday columns, consumer spending is highly correlated with employment and wage income.

Allied to this is the source of the fourth downside risk. For must consumers (and particularly those in the US) their homes account for the vast proportion of the wealth they possess. As I have shown previously, at the core of the global financial crisis and credit crunch is the bursting of the private housing market bubble in the United States. The securitization and leveraging of these household mortgages are at the heart of the global financial crisis, credit crunch, and financial panics over the past year. Until this market fully recovers, no one can be sure that the global financial system is stable and would not be prey to repeated episodes of financial contagion.

Stock markets, stress tests and inflation

The well publicised recovery of stock markets world-wide, and in particular stocks in the financial services sectors should not lead us to believe that all is well. Already for this year 94 banks have been closed in the US, as compared to 25 last year. And, for the four preceding years (2004-2007) only seven bank closures took place. This is a stunning statistic, not widely appreciated in our region.

Indeed it is because of such happenings that the stress tests I previously wrote about were conducted for the 19 largest banks in the United States, all of them considered as too big to fail. The report card on these called for further capital injections to cope with the risk of systemic collapse. Of note, similar tests have not been conducted for other huge global banks in Europe or Asia. As such, we do not know what surprises they might have in store for us.

Another important downside risk is that the financing of stimulus packages will see an increase in government indebtedness. In some instances this will be huge as not only did governments borrow to finance stimulus spending, but they also created debt to shore up financial institutions on the brink of collapse. Examples of these are the infamous financial bailouts introduced by President Bush in the USA and continued (and perhaps even championed) by his elected successor, President Obama. At the time of these bailouts it was widely assumed by governments and financial/economic experts that if this did not happen, the global financial system would suffer a catastrophic systemic collapse.

The concern about all this government debt is that it could lead to global inflation. History has repeatedly shown that when government debt becomes very large it feeds an inflationary outcome. Readers should also note, because it is not widely acknowledged, that such a financial outcome is of benefit to governments. Why? The answer is that inflation always reduces the burden of government indebtedness.
The final major downside risk is growing protectionism and the collapse of world trade. Indeed this was the unfortunate result of the Great Depression of the 1930s, from which lessons learnt then remain very valid today.

Next week, in the context of this assessment of the state of the global economic crisis, I shall discuss what we should learn about trade policy.

Guyana and the wider world

By Dr Clive Thomas | October 4, 2009 in Features, Sunday

Coping with crisis: trade matters

In the coming weeks I shall seek to establish why it is I believe that trade policy, at the global and national levels, represents the third and final important lesson to come out of recent worldwide efforts to cope with the global economic recession, financial crisis and credit crunch (squeeze).

Recovery and risks

I had claimed last week, the admittedly growing widespread optimism that economic recovery will take place for most economies some time during this, the final quarter of 2009 and in some instances going well into 2010 has to be juxtaposed against several crucial downside risks which could serve to deny this projected outcome. I had highlighted six of these downside risks last week. The first downside risk I pointed out is that the recession could take a 'double-dip' particularly if the stimulus packages, which are presently shoring up national expenditures in the leading economies are withdrawn for whatever reasons, too early. One possibility is that premature or precipitate terminations of stimulus packages could follow from an overly optimistic view that recovery is already firmly underway. Second, consumption, which represents a large share (70 per cent and more) of national expenditure in the leading industrialised economies, has not yet rebounded enough to be able to sustain a continued rise in overall national expenditure in the period to come. As a result the recession could return.

Third, so far economic recovery has not led to job creation in virtually all economies. This is of some concern since employment is a major contributory factor to consumption expenditure and thus global recovery. Fourth, the housing market crisis and its repercussions on residential home mortgage securities markets in the leading economies have not been resolved. The so-called toxic assets that nearly brought down the global financial system and created the credit crunch as well as a massive loss of confidence among investors have not disappeared, even though there is very little discussion of this issue today.

Fifth, the deficit financing that has provided for the stimulus package of governments around the world, opens up the prospect of future inflation down the road. The sixth downside risk which I highlighted is growing protectionism. This could well lead to the collapse of global trade. Based on international experiences in the 1930s it is a natural response for governments that are undertaking countercyclical expenditure at times of economic distress to want to focus on those projects which seem to bring immediate benefits to their peoples and constituents. 'Buy local' campaigns are thus very effective, because they hit a responsive chord among the population.

The fallacy of composition

The truth is, however, that if all economies pursued such an objective, then the exports of all countries would decline. In turn falling economic growth, reduced employment and declines in consumption would be accompanied with declining opportunities for international trade. In today's global economy, much more than at any previous historical period, economic performances of all economies are highly contingent on opportunities for global trade. Before I demonstrate why this is the case, let me first draw a parallel with the so-called miserly approach of practising thrift and prudence at times of economic catastrophe. Most Guyanese have grown up with the old adage fixed in their minds: 'Always save for a rainy day.' When the advice is given to one person and he/she follows it, it becomes very useful advice. At times of economic uncertainty, however, if all persons follow this adage savings would rise and spending would fall. But at times of economic hardship, as I have previously shown in the discussion of stimulus packages, you do not want spending to fall. Economists refer to this more generically as an example of the 'fallacy of composition.' What is good advice for one individual is bad advice when all individuals or a large number of individuals follow it.

There are several instances of international agencies advising Guyana and Caricom governments to pursue projects for which they claim there are excellent market prospects. They then proceed to give the same advice to scores of other developing countries facing similar production possibilities, urging them to follow suit. When these many other countries do the same, what were excellent market prospects disappear. Overproduction, price collapse and a market glut follow. The projects become a nightmare for those owning and executing them.

Globalisation and openness

The basic reason why trade policy is so vitally important is that since the rampant advance of globalisation after the 1980s, the global economy has become unprecedentedly more open. The global prosperity of the past three decades has unmistakeably been dependent on the rapid expansion of global trade in goods and services. Indeed it has been calculated that three-quarters of global growth in GDP in recent times has been dependent on the growth of global trade in goods and services.

I had previously given the example of the United States economy in these columns. In the 1960s, the US economy was largely self-sufficient. External trade, and this was confined then largely to trade in goods (merchandise trade), accounted for about ten per cent of US GDP. Since then the growth of US trade, like global trade, has been faster than its GDP. The result is that today the US trade/GDP ratio is about 30 per cent. Additionally, US trade has shown a most dramatic expansion in the rising share of trade in services. With this sort of global openness, if countries turn inwards at times of crisis, and adopt measures to bias expenditures away from imports and towards domestic suppliers, global trade will enter into a downward vicious cycle. For as incomes decline and employment worsens, if cuts are made in imports (other countries exports) these will call forth cuts in imports (our exports) by other countries with rising negative multiplier effects felt among an expanding number of countries.

Next week I shall continue the discussion from this stage and supply important data in support of the spread among both rich and poor countries of increasing dependence on international trade in goods and services for their economic prosperity. In this sense trade matters to all countries. None is exempt from this dictum.

Guyana and the wider world

By Dr Clive Thomas | October 11, 2009 in Features, Sunday

Staring at the Abyss of Global Trade Collapse

Why Trade Matters
At times of global economic and financial crisis keeping trade open matters in this the new age of explosive globalisation. As I pointed out last week about three-quarters of the increase in global GDP growth in recent years has been attributed to the expansion of trade.

The world economy is immeasurably more open today than in earlier historical periods. Even the most self-sufficient economies, to take two contrasting examples, China and the United States, have become very trade dependent. As a result, the prosperity of not only these two countries, but that of practically all nations, depends on the continued expansion of global trade.

Because of this, there is great concern over global and national efforts to exit from the strategies introduced to cope with the global recession. The fear is that premature termination of stimulus packages could trigger a "double-dip" in the global recession. Added to this, there is the continued need to guard against the disaster of governments designing stimulus programmes to reduce import dependence and/or promote export-led growth.

As I have previously observed it is very tempting to seek to bias stimulus packages in support of domestic sectors and jobs through increasing domestic demand. As we shall see more clearly in the course of later discussion of this topic, the threat of such inward-looking and protectionist approaches in national efforts to cope with the global economic crisis is a real and pressing one. Of particular concern is the estimate that global stimulus packages presently account for three percent of global production and trade!

Breaking the Trend
In every year over the past quarter of a century (1982-2008) the volume of global trade (or trade in real terms, not nominal values) has expanded. This is a remarkable trend. However, for the first time this year, according to the World Trade Organisation (WTO) global trade is projected to decline by as much as nine percent! This decline is best appreciated when compared to recent growth rates of global trade. In 2006 the volume of global trade grew by 8.5 percent. And, in 2007, it grew by 6 percent. In 2008 global trade fell to 2 percent, but most of the decline came in the second half of the year, after the financial crisis had exploded.

Readers would recall from earlier discussions in these columns that between the third quarter of 2007 and mid-2008, there was rapid growth in trade and an explosion in food and fuel prices. Oil prices peaked at US$147 a barrel and some food prices trebled.

There are other estimates of the likely decline in global trade this year. Some, like the World Bank's are lower (6.1 percent); and, others higher. Thus the Organisation for Economic Cooperation and Development (OECD) has estimated a 13.2 percent decline in global trade for this year. In all the estimates I have seen however, most of the decline is expected to occur in developed economies.

Thus the WTO projects a particularly severe decline of 10 percent for developed economies this year, and for developing countries a decline of between 2-3 percent. This is significant because the developing economies as a group are for more dependent on trade for growth.

Trade has been an engine of growth for developing countries and particularly the group classed as the least developed countries (LDCs). UNCTAD data reveal the rapid growth and deep dependence of poor countries on trade. Thus the ratio of exports to GDP for developing countries was 26 percent in the mid 1990s. By the end of the pre-crisis year (2007) this ratio had nearly doubled to 51 percent. For the LDCs the situation was more striking. The ratio rose from 17 percent in 1995 to 45 percent in the 2007, an increase of 165 percent. In the case of the Latin American Caribbean region, the ratio has risen from 13 percent in 1995 to 30 percent in 2007. This is an increase by a factor of 2.3.

Cancelling Out Gains

With these data we can see why the global economic crisis risks the cancellation of economic gains made by developing countries since the mid-1990s.

It certainly puts at risk the attainment of the Millennium Development Goals (MDGs), several of which I have already pointed out in earlier columns, institutions monitoring the MDGs (the World Bank and the United Nations Development Programme) have indicated.

It should also be borne in mind that the projected decline in global trade is taking place in conjunction with the first decline in world GDP since the 1930s. Indeed the argument here is that the two reinforce each other in a cumulative negative spiral.

Over the past few years most economists had expected that with the increasing share of poor countries in global trade, and the noticeable diversification in the pattern of international trade flows, economic disruption in rich countries would not have led to the severe repercussions of the past. That is: "when the rich countries sneezed the poor ones would catch a cold or worse, pneumonia".

Despite the diversification of trade in the major emerging markets of Asia, Latin America and Eastern Europe, and the rise of South-South trade, the WTO has found there is no evidence of a "decoupling effect" that could have made poor countries less exposed to a global economic crisis centred in the US economy.

At this stage therefore we need to address two issues. One is, what efforts have been made at the global level to treat with trade as an integral response to strategies for coping with the global economic crisis, financial crisis and credit crunch?

This involves principally looking at efforts coordinated at the G20 and global financial institutions, especially the World Bank and the International Monetary Fund (IMF). The other issue is the state of international negotiations on global trade at the WTO.
Before we get to these, I need to clarify next week a few issues readers have raised on matters touched on so far in the discussion of trade policy as a crucial lesson to be learnt from coping with the present global economic crisis.

Guyana and the wider world

By Dr Clive Thomas | October 18, 2009 in Featured, Sunday

Responding to Some Readers Queries

Last week I indicated that I would respond to three queries which readers have raised, before turning to evaluate the trade policy proposals of the G20 for resolving the current economic crisis and hopefully establishing a secure platform for the robust resumption of global trade. As might be expected the G20 positions are directly linked to the state of global trade negotiations under the auspices of the World Trade Organisation (WTO). As I was at pains to stress last week, a premature exit from global efforts to contain the negative effects of the economic crisis and a rushed return to "business as usual" could be disastrous, given the bleak projections for global trade this year.

Services

The first query stems from the fact that while many readers readily recognise global "trade in goods", they fail to comprehend what trade analysts mean, when they refer to "trade in services". The reason for this is that trade in goods (merchandise trade) is easily recognised. They encounter this frequently when customs personnel record and process items, at ports of entry and exit in and out of the country. Readers therefore wonder: how and where is this "trade in services" being recorded? I had previously responded to a similar query several years ago in this Sunday column. Let me try again.

During global trade negotiations under the Uruguay Round (1986-1993), negotiators adopted the principle that trade in services could take place in four ways only. These are called the Four Modes of Services Supply. Mode 1 refers to cross-border supply. This occurs when services are delivered across a country's border to consumers abroad, and the suppliers of the service remain in the country originating the supply. Examples of this occur when we purchase American movies online or download music online for a fee. It also happens when we use a foreign airline to travel to another country. Indeed there are literally thousands of ways in which Guyanese routinely buy and sell services abroad, while remaining at home.

Mode 2 refers to consumption of services abroad. This occurs when consumers travel from one country to another to purchase a service. The commonest example of this in CARICOM is when persons travel as tourists to holiday abroad. Thus, if a Guyanese travels to Grenada for a two weeks holiday, the expenditure made on this trip is treated as a tourism export of Grenada.

Mode 3 refers to instances where services are provided through the establishment of an enterprise in another country in order to supply the service. Examples of these are the offices of foreign airlines, courier services, banks, and other financial institutions located in Guyana.

Mode 4 refers to the presence of natural person(s) supplying the service in another country. Examples of this occur when foreign-based doctors come to Guyana to supply medical services to Guyanese patients or when Guyanese teachers go abroad under contract to teach in CARICOM countries and further afield.

There is a clear distinction between this and migration. The natural person supplying the service abroad must be doing it on the basis of a contract, which stipulates a definite duration.

The total value of "trade in services" for CARICOM countries as a whole exceeds the total value of its trade in goods, although this does not hold true for Guyana. Globally, trade in services (exports) measured along these lines – totalled US $3.7 trillion in 2008, while global export trade in goods totalled approximately $US15.8 trillion. The average rate of growth of global trade in services has been approximately 12 percent during the period 2000-2008. In the last pre-crisis year (2007) it grew by 19 percent.

Transmission Channels

The second query has been: given such obvious shifts in global trade as 1) the rise of the BRIC countries (Brazil, Russia, India and China) 2) the expansion of South-South trade, and 3) the rapid growth of regional trade agreements (RTAs) among poor countries, what have been the main channels through which the present crisis, originally centred in the US and other G7 countries, have hit the poor countries so devastatingly?

In a recent study I did for the United Nations Economic Commission for Latin America and the Caribbean (UNECLAC) I identified ten main channels of transmission to CARICOM economies. Space does not permit a repeat of these here. Briefly however, they covered such channels as the decline in exports, particularly exports of services which are sold mainly to US and European consumers; an accompanying decline in foreign direct investment (FDI) to the Region, as well as overseas development assistance (ODA) from traditional sources; and, the adverse impact on the region's terms-of-trade, caused by the prices of exports falling faster than those of imports.
Additionally, there were other financial and income effects.

For one, the drastic decline in the inflow of remittances as the decline in earnings of the regional Diaspora in North America and Europe was felt, as well as financial contagion caused by the collapse of major regional-based financial institutions (CL Financial Group in Trinidad and Tobago and the Stanford International Group in Antigua-Barbuda). The fact also that the region's foreign exchange management is based on a fixed parity with the US dollar has made these effects worse. Variations in regional exchange rates did not respond to regional macroeconomic conditions, but to the global market for the United States dollar.

What has credit got to do with trade?

The third query is based on my insistence that the crisis has three distinct components: 1) economic recession 2) financial crisis, and 3) credit squeeze (crunch).

The query is: what effect has the latter two had on trade, apart from the obvious spill-over to the real sector of collapsing financial firms. To be brief, it should be kept in mind that 90 percent of all international trade transactions involve credit! The credit shortage and freeze which accompanied the global crisis has severely impeded access for firms to trade credit and so trade itself.

In the coming weeks I shall resume the analysis of trade policy issues as put forward by the G20 and consider the state of global trade negotiations under the WTO Doha Round.

Guyana and the wider world

By Dr Clive Thomas | October 25, 2009 in Features, Sunday

Pledging trade policy reform to cope with the global crisis

Recap
Last week's column responded to three queries readers had raised in regard to my earlier discussion on trade. One of these was to explain how "trade-in-services" is accounted for, since they already knew from experience what is meant by "trade-in-goods", sometimes called "trade in commodities" or "merchandise trade". A second was to explain why, given the major structural changes in global trade patterns and relations, poor countries (including CARICOM) continue to be vulnerable to a global economic crisis that originated in the collapse of financial markets in rich countries. And, finally to explain why, apart from the accompanying recession, a financial crisis and credit crunch would negatively impact global trade.

The information I have provided in responding to these queries will be useful for the discussion in coming weeks. I plan to evaluate global efforts to develop coordinated trade policies. Especially in light of the juxtaposition of 1) the substantial contribution international trade has been making in recent decades to global growth and 2) the significant decline in world trade projected for this year.

From G8 to G20
Before I assess trade policy responses to the global economic crisis, however, readers should be aware that in response to recent experiences there have been striking changes in the organisation and management of the international economy. Based on sheer economic clout and market size the G7 and subsequently the G8 grouping of countries, had decades ago arrogated to itself final decisions on global economic strategy and policy.

The major international organizations they had helped to create earlier, particularly the International Monetary Fund (IMF) and World Bank (established after World War II and known as the Bretton Woods Twins) as well as the World Trade Organisation (WTO) established in 1995 (to replace the General Agreement on Tariffs and Trade, GATT) were made responsible for day-to-day implementation, execution, and management of G8 policy.

Because the G8 comprises only the United States, the United Kingdom, Canada, France, Germany, Italy, Japan and Russia it could not speak for the rapid emergence of such global powerhouse economies as Argentina, Brazil, China, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea and Turkey, previously classed as "developing economies". Their roles in global and regional economies have now become so enormous that they can no longer be side-lined from international efforts to restore the global economy and/or prevent a recurrence of severe global economic crises in the future. Out of this concern the G20 has risen to become the premier organisation which is now coordinating international efforts to deal with the global economic crisis and its aftermath.

Since the crisis erupted just over a year ago the G20 has met on three occasions. The first time (November 2008) was at the invitation of the then President of the United States, George W. Bush. The second meeting took place in April 2009 (London). And, recently its third meeting since the crisis was held in September 2009 in Pittsburgh.

As explained in earlier columns, the G20 comprises a group of twenty Finance Ministers and Central Bank Governors from 20 countries.

These are the persons holding national political portfolios for dealing with the crisis (Ministers of Finance) and those holding the highest level technical responsibilities for so doing (Central Bank Governors).

The composition of the G20 countries include the G8, the ten emerging economies listed above, the rotating President of the European Union and its Central Bank, and Australia. Spain and the Netherlands are specially invited. In addition the IMF, the World Bank, their Development Committee, and the International Monetary and Finance Committee are in attendance.

While the G8 represents about two-thirds of global GDP and the vast proportion of the world's scientific, industrial, military, and Research and Development (R&D) capability, it only covers about one-seventh of the world's population. The G20 is far more representative. It accounts for approximately 85 percent of global GDP and more importantly for present purposes, 80 percent of global trade. It is far more representative of today's global population than the G8, accounting for about two-thirds of this. However, as I have previously urged, the G20 is in no way a substitute for a fully-fledged United Nations Economic Security Council.

Trade Policy

This extended description of the shift of global economic management from the G8 to the G20 has been accompanied with a pronounced emphasis on trade policy as part of the solutions to the global crisis. At the first Washington G20 Summit, the final Declaration committed their governments and global economic institutions to "maintaining open trade and investment policies". This was combined with expressed support for a broad neo-liberal agenda of 1) free market principles 2) the rule of law 3) respect for private property 4) competitive markets and 5) efficiently and effectively regulated financial system as a cornerstone strategy for fighting the global economic crisis.

By the time of the Second G20 Summit (April 2009) WTO and other world trade projections, which we have already looked at, were predicting a sharp decline in global trade for this year, as much as nine (9) percent. Not surprisingly, as a result the Summit focussed a great deal of attention on trade issues.

Of the six major pledges made at that Summit one was "to promote global trade and investment and reject protectionism to underpin prosperity."

The pledge on trade was accompanied with a number of specific commitments, some of which reaffirmed others that had been given previously. The goal behind this pledge, and indeed all the others, was "to bring the global economy out of recession and prevent similar crises in the future". It was made in recognition of the critical importance of world trade and investment toward ending the recession.

For the benefit of readers, the other pledges were 1) to restore confidence in the global economy, promote growth and provide jobs 2) end the financial crisis and credit crunch so as to restore lending and "repair" the financial system 3) restore trust in the financial system through strengthening regulation 4) reform global financial institutions and enhance their funding and 5) promote sustainable and environmentally-friendly development.

In the coming weeks, I shall indicate and evaluate the specific commitments to trade policy measures made by the G20.

This will lead into a discussion of the state of the WTO world trade negotiations under the Doha Round.

Guyana and the wider world

By Dr Clive Thomas | November 1, 2009 in Features, Sunday

The Fool's Gold of Global Economic Diplomacy: Pledges Made by Rich Countries to Poor Ones

CARICOM and the G20

In my column last week I was at pains to acknowledge the astounding rise of the G20 grouping of countries to the undisputed lead position in international efforts to contain the global economic recession, financial crisis and credit crunch. G20 leadership has encouraged a strong emphasis on policies designed to deal with the fall-out from declining international trade and investment. The G20 recognises, as much as any grouping of countries that open policies are essential in order to prevent further declines in international trade and investment from dramatically worsening the negative impacts of the global economic crisis.

I had also pointed out in that column the G20 is far more representative of the global community of nations than the G7 or G8. However, it is important to note that it still only represents 20 countries. That is, the equivalent of approximately 15 percent of the total number of global economies. The absent 85 percent of these are correctly, concerned about their exclusion. Further, many countries feel very strongly that Europe is over-represented in the G20.

Many small vulnerable economies like Guyana feel that they have no representation in the G20. It is true that altogether the small relatively poor vulnerable and open economies represent a negligible proportion of global GDP and trade. Their number however is far larger. More importantly, they are also sufficiently different from other global economies, especially in regard to their dependence on the global economy that their special needs should be recognized. It is not surprising therefore that the Assistant Secretary-General of CARICOM is reported as having raised with the United States' Secretary of State the Region's concerns about not being represented at the G20.

G20 Pledge: Promote trade and investment and reject protectionism
Based on the pledge made at the G20 Summit "to promote global trade and investment and reject protectionism" that was referred to in last week's column, at least seven specific trade and trade-related commitments have been made by the G20 thus far. These are referred to below in no particular order of ranking.

One of these is the commitment that the G20 has given not to raise in their respective economies new barriers to either investment flows or trade in goods and services. This in turn has required three further policy assurances. First that no new import restrictions would be imposed. Second no new measures to stimulate exports would be introduced, which might be considered inconsistent with the World Trade Organisation's (WTO) rules and regulations. Third all measures in this regard, whether thought to be inconsistent or not, would be immediately "notified" to the WTO and promptly rectified, if so required.

A second commitment given by the G20 is to ensure that the negative impacts on trade and investment of all domestic policy actions are minimized. These domestic policy actions would include fiscal measures (taxes, subsidies and government expenditure) as well as financial policies (credit, bailouts and reinsurance designed to support the domestic financial system).
The third commitment is for the G20 countries to avoid at all costs the temptations of "financial protectionism". This would cover in particular financial and capital restrictions that could impede worldwide capital flows (mobility), especially where the developing economies are concerned.

The fourth commitment already given concerns "notification obligations" to the WTO and other international organisations. The G20 has committed to the regular monitoring of such obligations and specifically to the reporting of these on a quarterly basis.

The fifth commitment requires the concerted promotion and facilitation of both trade and investment as part of the G20 obligation to promote open economies, as the foundation for economic recovery and the non-recurrence of future global economic crisis.

The sixth commitment is much more specific. Members have agreed to make available over the next two years (2009/10); no less than US$250 billion, to support trade finance. It is expected that these funds would go mainly to export credit and investment agencies through multilateral development banks like the World Bank. In addition regulators in the G20 countries would be asked to make use of all available flexibility in capital requirement for trade finance.

The seventh commitment given is easily the most ambitious and far-reaching. The G20 countries committed as a group to conclude the Doha Development Round of multilateral trade negotiations. Their estimate is that conclusion of the Round would add over a US$150 billion annually to the global economy.

WTO Negotiations
In anticipation of our next topic of discussion, which is the Doha Development Round of WTO trade negotiations, readers should note that this commenced at the end of 2001 (November) in Qatar, Doha. The stated goal then was to complete the Round by January 1, 2005. The time that has elapsed since its original scheduled completion date and today is substantially longer than the three years originally given for the completion of the negotiations.

Next week I shall turn to a discussion of the WTO's Doha Development Round. But before I do that I need to evaluate how the commitments made by the G20 during the crisis have stood the test of practice. As we shall see it has been easy for the G20 to be "long" on commitments, but "short" on the actual fulfilment of specific measures to which countries have committed themselves. As this continues to hold true a "credibility gap" emerges with the G20. This is not surprising, as in global economic diplomacy, time and time again, pledges made by rich countries to support poor ones have turned out to be fool's gold at the end of the rainbow of well-promoted humanitarian promises.

In the case of the Doha Development Round, such a gap already exists. The "face-off" between the rich developed economies on the one hand, and the rapidly emerging economies like Brazil, Russia, India and China on the other, are at the heart of the failure so far for global multilateral trade negotiations to conclude the Doha Development Round. This does not gainsay the fact that other key issues, like the failure to address adequately development issues is not also at the centre of the stall in global multilateral trade negotiations.

Guyana and the wider world

By Dr Clive Thomas | November 8, 2009 in Features, Sunday

All that glitters is not gold: Harvesting the broken pledges of the G20

In last Sunday's column I had described the many pledges made in the past by rich countries to come to the aid and support of poor countries as the 'fool's gold' of international economic diplomacy. Rich countries have been only too eager to make publicized pledges to help poor countries, but in practice they have been very unwilling to honour these. For the global mainstream media, the propaganda benefit of making a dazzling new pledge is great. There is, however, an old adage: "all that glitters is not gold."

Fanfare

Easily, the most notorious example of unkept pledges started with the fanfare, which accompanied the pledge made at the United Nations General Assembly in October 1970, by Members of the Organisation for Economic Cooperation and Development (OECD). On that occasion it was solemnly pledged: "Each economically advanced country will progressively increase overseas development assistance (ODA) to the developing countries." More specifically, the rich countries committed to making their "best efforts to reach a minimum amount of 0.7 percent of GNP at market prices by the middle of the Decade of the 1970s" (United Nations Resolution 2626 (XXV) October 24, 1970).

Astoundingly, almost all rich nations have failed to honour this pledge. At the end of last year (2008) only 0.3 per cent of the rich countries gross national income (GNI), (which totalled approximately US$120 billion at 2007 prices) was actually given. This total was short by US$260 billion at 2007 prices, as the 0.7 per cent figure originally pledged would have totalled $US380 billion!

The perceptive reader would have noticed several important points in the previous paragraph. First, instead of using GNP as originally pledged, the information given is based on GNI. The reason for this is that, over the years, the OECD has substituted GNI for GDP, because the former is a lesser amount. Second, the year for which the information is presented above (2008) is 38 years after the year in which fulfilment of the pledge was originally promised!

As a matter of fact, since the mid-1970s several other changes have been made to dilute this pledge further. For example, in 2006 the European Union redefined its pledge at 0.56 per cent of GNI by 2015. Over the years it has also been observed that most of the aid given has been directed at supporting the strategic interests of the donor countries. That is why Iraq is the largest aid-receiving country in the world and also why Afghanistan is number 3.

Furthermore, studies have revealed that donor country aid has subsidized the exports of donor countries. Even in the case of technical assistance, it has been found that over 80 per cent of technical assistance funds from some donor countries go towards paying consultants and consultancy firms of the same donor countries.

Many readers would no doubt have heard of the widespread practice of 'tied aid,' which has come in for strong criticism by development experts.

ODA has been precisely defined by the Development Assistance Committee of the OECD. It covers four specific situations. First, aid refers to activities of the official sectors of the donor country. Private funding is definitely not included in ODA.

Second, the funding provided has to be directed at promoting economic development and welfare. Third, to qualify as aid it also has to be given on concessional financial terms. That is, it must be cheaper than funds available in private commercial markets. Fourth, technical assistance/cooperation is classified as aid. However, grants, loans, and credit for military purposes are not.

Monitoring

As we saw, the G20 grouping of countries includes major emerging markets like Brazil, Russia, India and China (BRIC). These four in particular have formerly championed poor countries in their fight for global economic reform, justice and fair play. Sadly, however, in the course of the global economic crisis they have quickly adopted the practice of false pledges similar to the rich countries.

The World Bank in keeping with the G20 pledge (discussed last week) to encourage regular reporting of their actions in relation to the pledges they have published a Fact Sheet on the pledges. This noted "within three weeks following their April Summit, nine (9) members of the G20 had either implemented or were putting in place new measures to restrict trade." Six members had indeed implemented trade restricting measures (anti-dumping) and safeguard measures, which violated WTO rules.

The World Bank had no doubt expected that by naming the countries, it would have shamed them, and consequently discouraged them from persisting with protectionism. This has not been the case. As the Secretary-General of UNCTAD later observed, under the G20 we are facing: "a rising tide of protectionism despite G20 pledges." He went on to state "almost all countries have gone back on their pledges due to the pressures of economic nationalism." The G20 is therefore losing credibility as it appears to be taking the classic rich countries' stance of 'do as I say, not as I do.'

There is no doubt that many excuses can be made, and indeed have been made for this betrayal. It is true that countries face tremendous economic and political pressure from their domestic constituents. This encourages them to turn a blind eye to their global commitments.

The reality is, however, if the global economy turns inward on itself and prosecutes beggar-thy-neighbour trade policies, a horrendous and cataclysmic global catastrophe will befall all humanity. Countries cannot, and indeed should not, be allowed to find solace for their own violations, by claiming other countries are also violating. The poor countries in the world deserve better.

Conclusion

The conclusion from all this is that the credibility gap between pledges and actions designed to fulfil these pledges will make it next to impossible for the G20 to jump-start the Doha Development Round of multilateral trade negotiations under the auspices of the WTO.

Already, there is no hope that these negotiations can be completed by the end of this year, which was the expectation coming out of the April G20 Summit.

The G20, with its potential to add a new dynamic to the design and implementation of global economic policy, is now appearing to be more and more like an extended G7. The sad reality is that, the BRIC countries are coming to see in the G7 images of their own future.

And, they seem to like what they see. Sadly, calls for a new international economic order will therefore continue to have little or no standing among countries in the age of globalisation under the dispensation of the G20.

Guyana and the wider world

By Dr Clive Thomas | November 15, 2009 in Features, Sunday

A tale of betrayal: Driving the juggernaut of trade barriers against poor countries

Several readers have expressed surprise and disappointment on reading in last Sunday's column that the G20, which includes so many former champions of poor countries in the global economy are now flagrantly doing what the rich G7 countries had been doing for decades previously. That is, making pledges of support and then in a matter of weeks openly breaking these pledges. In this week's column I shall extend my discussion of this betrayal a bit further.

In June this year the Global Trade Alert (GTA) was launched. This group is dedicated to monitoring increases in government protectionist measures worldwide during the course of the present global economic crisis. This is an initiative of the London-based Centre for Economic Policy Research. As readers would know from previous columns, the G20 has made stout pledges to promote 1) the relaxation of traditional trade barriers (tariffs, quotas, subsidies, etc) 2) the removal of other trade-distorting mechanisms and 3) international efforts to monitor their performance in these areas. The GTA has taken the G20 at its word, and has focused on how they are keeping their pledges.

So far the GTA has published two reports. Both have turned out to be very damning. They support my contention that the G20 is behaving in a similar manner to the G7, when it comes to their pledged obligations to help poor countries through promoting access to their markets and promising no protectionist measures. In these two reports the GTA has provided the results of their investigations of public initiatives/measures that have implications for global trade and investment. These totalled 425 up to the time of the publication of their second report in September. The overall conclusion they arrived at is telling: "These investigations reveal the emerging contours of crisis-era protectionism and the fealty of G20 governments to their November 2008 no-protectionism pledge."

Disturbing details

Let us observe some of the disturbing details in the report. First, the report established that by September 2009, the number of protectionist measures worldwide, had outnumbered the number of trade-liberalizing measures already implemented, by the astonishing ratio of five to one (5:1). Second, the evidence the report uncovered led it to conclude that what had occurred has reversed the 25-year pre-crisis trend towards more open borders and reduced restrictions on trade. Third, initiatives and measures in the pipeline (that is those which have not yet been implemented) total 140. Of these, as many as 134 seem certain to "discriminate against foreign commercial interests when implemented."

The GTA Report has famously spoken of the “protectionist juggernaut” continuing under the auspices of G20. It describes the G20 as a “serial violator” of its own pledges. Indeed these nations were found to be responsible for 172 of the state initiatives the GTA had investigated. Of these, they found that 121 tilted the playing field against foreign commercial interests. As the report further pointed out, given that the global economic crisis was 300 days old by the time of its September publication, this meant: “That, on average, a G20 member has broken the no-protectionism pledge every three days.” Further, the global reach of these violations has been enormous, harming every region and continent, as well as both rich and poor countries alike.

With such a track record of betrayal the G20 has lost much of its moral authority and credibility. Indeed, I would argue so badly that, in all likelihood, it will fail to jump-start the Doha Development Round of multilateral trade negotiations under the auspices of the World Trade Organization (WTO).

The Doha Round

As I have previously indicated the Doha Development Round, which started eight years ago in November 2001 was originally scheduled for completion by the beginning of 2005. The round has many unique features. First, it explicitly places trade issues in the context of the global development problematique. Since its establishment (1995), the WTO has always insisted that it is not an international development organization like others, especially the World Bank. If it is to promote development it can only do so as a consequence of its promotion of freer and more open access to international trade in goods and services.

Secondly, as the Doha Round has progressed the focus on multilateral trade negotiations has been broadened to include trade in goods (merchandise trade) and services, as well as a plethora of trade-related issues. These latter include such items as geographical indications; state trading; trade and competition; trade and investment; trade and the environment; trade-related aspects of intellectual property rights, plus a range of trade implementation issues.

Fourth, the round has directed attention to key development concerns like 1) capacity-building for developing countries to enable them to participate in trade liberalization and cope with any trade-adjustment consequences 2) special and differential treatment for developing countries and 3) the special concerns of small countries.

It is general knowledge that the Doha Round has stalled. As mentioned last week, over the years, three key contributors to this stall have been 1) difficulties in satisfying the legitimate expectations of poor developing countries 2) systemic conflicts between the established rich countries (G7) and the rapidly growing emerging market economies, especially the BRIC grouping (Brazil, Russia, India and China) and 3) the global economic crisis, which has brought effective negotiations to a halt, since last August.

It was hoped that with the emergence of the G20 as the lead international grouping to deal with the global crisis it would have been able to leverage global efforts in favour of a resumption of the WTO negotiations by the third quarter of this year, with the further expectation of a completion of the full round by 2010. At present this is most unlikely for two reasons. First, the G20 has lost credibility because it has been a serial violator of its own pledges. Second, the fear is that, as the global economic crisis shows signs of easing, nations will reduce cooperation and return to business as usual.

Guyana and the wider world

By Al Creighton | November 22, 2009 in Features, Sunday

Jump-starting the WTO negotiations: Can the serial violators deliver?

As this column noted last Sunday, despite including nations which earlier had staunchly championed the cause of poor countries, the G20 since leading the coordination of international efforts to tackle the global crisis has turned out to be like the G7 before it, a serial violator of its pledges to help poor countries. All monitoring reports that I have seen show that the Group is pushing 'the juggernaut of protectionism.' Their erection of trade barriers has seriously harmed poor countries' exports to them.

Some readers have asked me whether the G20's repeated violations of pledges have been confined to their trade obligations.

The answer is that I do not know. I have not come across monitoring in other areas similar to the level of professional monitoring of trade pledges covered in the Global Trade Alert's two reports published since the crisis began a little over a year ago. I would hope similar work is being undertaken.

Personally, I am keenly interested in the execution of the G20's pledge to put in place stronger anti-money laundering standards to help stem the flood of looted funds from the treasuries of poor countries.

In effect what the G20 has done is to task the inter-governmental body, which monitors and regulates global money-laundering (The Financial Action Task Force) to exhibit the same tight supervision of funds transferred by state officials as they do for suspected movements of terrorist finance.

This week I shall conclude my discussion of the lessons to be learnt from international efforts to cope with the global economic crisis. The lesson that I least expected and which has disappointed poor countries and those that are concerned about their welfare the most is the G20's emergence as a serial violator of its pledges. The direct consequence of this is that, with the reputation of the G20 at stake, there is no credible momentum behind efforts to the jump-start the Doha Development Round of multilateral trade negotiations started eight years ago (November 2001) and originally scheduled for completion at the beginning of 2005.

WTO ministerial conferences
With their accompanying demonstrations, protests, riotous manifestations and violence, WTO ministerial conferences have acquired a remarkable notoriety. Heated public

conflicts between globalizers, free-traders, neo-liberalists and anti-globalizers, anti-capitalist elements, in alliance with some poor countries have not been confined to verbal and written exchanges, but have frequently after spilled over into streets on the occasion of the WTO ministerial conferences.

Six have been held so far since the WTO's establishment in 2005: Singapore (1996); Geneva (1998); Seattle (1999) Doha (2001) Cancun (2003) and Hong Kong (2005). Although the WTO rules specify that one should be held every two years none has been held since Hong Kong (2005). One is presently scheduled for November 30 to December 2, 2009 in Geneva.

Previous ministerial conferences have been the place where breakthroughs in the negotiation process were planned. It is usually expected that with the presence of the responsible political ministers, if state officials are deadlocked, the ministers will clear these away. It was this method of operation that helped make ministerial conferences the focus of global attention.

Fearful of a repeat of this experience, the Secretary-General of the WTO has urged, and it has been agreed that, the coming ministerial will not focus on the Doha Development Round negotiations per se but confine itself to the framework and context of operations of the WTO. In this regard the ministerial is planned to be part of the regular work schedule of the WTO and not a vehicle for negotiating the Doha Development Round.

No one sincerely believes, however, that negotiations on the Doha Round will not take place at the informal and non-formal levels. No doubt the Secretary-General hopes that by utilizing this approach he can defuse expectations and thus more easily win support for the conference from those who are skeptical of the Doha Development Round.

Many observers believe that the upcoming ministerial will not significantly propel the negotiations towards a successful conclusion by 2010. Several key players have made skeptical comments. As an example, Brazil is reported to have claimed the multilateral trade negotiations are at the moment, unravelling.

Stumbling blocks

This column will conclude by drawing very brief attention to some of the major stumbling blocks encountered in the negotiations process. In no order of ranking these are: first, agricultural subsidies given by rich countries to their farmers that have led to the suppression of the agricultural exports of poor countries and the expansion of rich countries' exports through lower (subsidized) prices. Several farmer groups from West Africa, which export cotton, represent one of the most infamous examples of the castrophic effect on poor countries of the agricultural subsidies provided by rich countries to their farmers. Second, most poor countries do not have competitive services sectors and are therefore unwilling to open them up to competition from well-established firms in rich countries. Third, in all of the trade-related areas the Doha Development Round is embracing, poor countries face similar competitive difficulties; for example in areas like trade and competition, investment, intellectual property rights and environment. There are also a large number of implementation concerns, such as the application of safeguard measures if trade liberalisation significantly disrupts the external trade and economies of poor countries.

Finally, there are the development concerns I have mentioned in earlier columns, like special and differential treatment, the special concerns of small economies, and funding support for poor countries as they embark on trade policy-changes: capacity-building and aid-for-trade financing.

Conclusion

In practice two considerations continue to flavour current efforts to jump-start trade negotiations. One is the ‘mini-trade wars’ now being played out among such key trading economies as China, the United States, the European Union and Russia. Tit-for-tat measures are regularly employed when any infraction to existing agreements occur. This poisons the atmosphere for negotiations. Second, the global crisis itself, along with the WTO projected decline in global trade of 9 per cent this year, has tempted countries to pursue protectionist options.

Next week, as promised, I shall shift gear and begin to tackle two issues which are very central to the future of Guyana. These are the political economy of the low-carbon development strategy and a revisit of my earlier thesis on the criminalization of the state in Guyana.