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Africa's Voice, Representation and Effective Participation

African Development Bank

The Policy Briefs on the Financial Crisis (PBFC) are produced by the Complex of the Chief Economist with contribution from other departments of the African Development Bank. The PBFC are intended to present analyses of experiences and lessons emerging from the Financial Crisis, so as to encourage policy debate that guides the search for sustainable solutions to the crisis.

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AFRICAN DEVELOPMENT BANK GROUP

Africa's Voice, Representation and Effective Participation

Meeting of the Committee of Finance Ministers and Central Bank Governors

Cape Town, South Africa,
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1. Introduction

There is a growing concern that the spill over from the financial crisis in developed markets and the resulting economic slowdown will threaten Africa's potential "Growth Take-off". A key challenge for the international community is to design and implement an appropriate regulatory framework which would manage risks, guard against excessive risk taking, while allowing financial institutions to innovate and support the real sector. An equally daunting challenge is to ensure that the regulation and governance of the international financial system and key global institutions are responsive to the needs and specific circumstances of developing countries. This will require more effective participation of developing countries in key decision-making processes in global institutional and governance bodies.

African countries have felt particularly disadvantaged, often excluded from international negotiations and decision-making on issues which have a significant impact on Africa's development prospects. The current financial and economic crisis provides an important opportunity to advance the objectives embedded in the Monterrey Consensus[1], to re-engage and revitalize Africa's voice and representation in the regulation of the international financial system, and to ensure that Africa's interests are taken into account when decisions are made.

The African Ministerial Conference of 12 November 2008 on the financial crisis highlighted the need for a comprehensive governance reform of the global financial system and the Bretton Woods Institutions (BWIs). The Conference, in particular, emphasized the need to adequately reflect the changing global economic realities and emerging challenges, with special emphasis on greater voice and representation for emerging and developing economies. The Declaration of the G-20 Summit on Financial Markets and the Global Economy during the same month also underscored the need for reform.

In the same Declaration, the Financial Stability Forum (FSF) was also called upon to urgently expand and broaden its membership of emerging economies. Other major standard-setting bodies (e.g. the Basel Committee) were also requested to promptly review their membership to ensure adequate voice and participa-

[1]The Monterrey Consensus emphasizes the following: "We stress the need to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting." (Paragraph 62). "A first priority is to find pragmatic and innovative ways to further enhance the effective participation of developing countries and countries with economies in transition in international dialogues and decision-making processes."(including participation in the decision making in the Bretton Woods Institutions) (Paragraph 63).

tion of developing nations. Acknowledging its central role in this process, the IMF was called upon to collaborate with the expanded FSF and other bodies, and work to better identify vulnerabilities, anticipate potential stresses, and act swiftly for effective crisis response.

The G20 has now established a number of Working Groups to report back to the meeting of G20 Leaders to be held in April. Working Group 4, to be co-chaired by France and Indonesia, will conduct a review of the mandates, governance and resource requirements of the World Bank and other Multilateral Development Banks in light of recent financial and economic events.

Working Group 3 to be co-chaired by South Africa and Australia will focus on IMF reform: reviewing its mandate, resources, and considering how to strengthen its governance, legitimacy and accountability.

2. Regulation and governance of the global financial system: New realities call for new principles

It is evident now that the new realities of the global economy call for a revision of the principles that form the foundation of the governance of the global financial architecture and the mandates of global financial institutions, especially the Bretton Woods Institutions (BWIs) which were established more than sixty years ago in very different circumstances. There is also a general consensus on the reexamination of the role of stakeholders and their interaction at the national, regional, and global levels. The ultimate goal is to establish mechanisms to increase global financial stability and harness global financial resources to meet the development needs of the poor.

The first argument for reexamining the principles of governance of the global system from a developing country (hence African) perspective is based on the mounting evidence that financial innovations and integration have dramatically made it more difficult to insulate national economies from shocks originating from beyond their borders(2). On the one hand, financial shocks have dramatic real sector effects. On the other hand, globalization and financial development as well as integration have increasingly reduced the power of conventional macroeconomic policy tools in response to shocks. As a result, countries are less equipped to deal with the direct and indirect effects of

[2] In recent years, financial market activity has outpaced the real sector in growth dramatically. The ratio of foreign assets and liabilities to GDP has more than tripled in industrialized countries and more than doubled in emerging and developing countries over the past 25 years.

external financial shocks. New strategies are therefore needed, and better coordination is required, at the global level to achieve global financial stability.

The second argument which has been advanced is that the *costs of failure of the financial system are socialized* not only at the national level, but also globally, as evidenced by the current financial and economic crisis. Indeed, national borders have become porous, making economies more vulnerable to external shocks. The impact of shocks is likely to be relatively larger for developing countries given that they are less equipped in terms of financial resources and regulatory capacity to undertake required emergency responses to major shocks. Certainly, African countries are not able to mobilize the resources needed to orchestrate major bailouts of financial institutions as has been observed in the United States and Europe. Measures to prevent major disruptions of the financial system globally and in developed countries are therefore of great interest for developing countries, including those in Africa.

Africa's needs are country-specific and they evolve with changing global circumstances, which create new challenges for the continent over time. These new realities call for a review of the principles that are at the foundation of global decision-making processes, and, more specifically, governance and representation in the global financial system and institutions.

Governance and Mandates

The G20 will consider ways of strengthening MDB governance, political accountability and effectiveness. Particular attention has been focussed on the composition and voting structure in the World Bank and the IMF Boards, and the call for greater representation from emerging and developing countries. The G20 discussions will feed into the Spring and Annual meetings of the IMF, World Bank and AfDB. African Ministers and Governors will want to ensure that their views are taken into account.

Voting power of countries participating in the global system and financial institutions, in particular, in the Bretton Woods Institutions, is determined on the basis that members' shareholding should reflect their relative positions in the world economy. Basic votes were added on the basis of the principle of equality of states as a way of protecting the interests of smaller countries during decision-making. Developed countries therefore enjoy a significant majority of voting power, while developing countries have witnessed a decline in their voting power in decision-making processes.

The second feature of the current framework is that many of the major policy decisions are taken by the executive boards of the BWI where developing countries are under-represented in terms of membership. For instance, forty seven sub-Saharan African countries are represented at the boards of the IMF and the World Bank by two executive directors. These directors have relatively, large constituencies, making it difficult to ensure that the diverse interests of African countries are adequately represented in informal processes that influence final decisions.

These principles may no longer be appropriate as the costs of inadequate regulation of the global system impact on all countries, as witnessed by the current crisis. To that end, the G-24 has called for an urgent need to achieve parity between developed and developing countries in the BWI voting structures and to give a greater voice to the poorest countries without diluting the relative voting power of any developing country.

To address these weaknesses, there is a need to *broaden partnerships* in debates over the reform process and to achieve a *healthy balance between multilateralism and bilateralism*. Enhancing the voice and representation of developing countries would improve the legitimacy and credibility of all international institutions, including the BWI. More importantly, it would assist in enhancing ownership of programs which is critical to achieving development effectiveness and quality results. Debates on voice and representation have taken place in both the IMF and the World Bank in recent years.

IMF

The 2006 IMF Annual Meeting endorsed a programme of governance reform to "better reflect the relative weight of member countries in the world economy and enhance the voice and participation of low-income members within the institution".

Members agreed on a package of reforms which included the following steps: a) an initial ad hoc increase in quotas for the 'most under-represented countries' – China, Korea, Mexico and Turkey; b) a new quota formula to guide the assessment of the adequacy of members' quotas in the IMF; c) a second *ad hoc* quota increase based on the new formula; d) an increase in basic votes, which effectively increases the voting power of those members whose voting power is below the Fund membership average as a whole, such as low income countries; and finally e) additional staff resources for the two Executive Directors representing African members.

The initial *ad hoc* quota increase for China, Korea, Mexico and Turkey has already been implemented and the Executive Board is in the process of developing a new quota formula. The element on basic votes requires an amendment to the Articles of Agreement – a relatively rare occurrence which requires the majority support of the membership.

In April 2008, the Board of Governors adopted a Resolution on quota and voice reforms, subsequently welcomed by the International Monetary Fund and the Financial Committee of the Board of Governors (IMFC) at the Annual Meeting. The IMFC stressed that it is was an important first step toward a realignment of members' quota and voting shares. The final stage for increased basic votes to become effective requires acceptance by at least three-fifths of the members, representing eighty-five percent of total voting power.

World Bank

Issues of voice and representation in the World Bank have also been the subject of debate for some years. In April 2008, the Development Committee concluded that: "We welcomed the Managing Director's report on the reform of IMF quota and voice. We encouraged the Bank to advance work on all aspects of voice and participation, keeping in mind the distinct nature of the Bank's development mandate, and the importance of enhancing voice and participation for all developing and transition countries in the WBG. We look forward to a process that is inclusive and consultative among shareholders, and to receiving concrete options from the Bank's Board by our next meeting with a view to reaching consensus on a comprehensive package by the 2009 Spring meeting."

Discussions have continued and are reflected in the Development Committee communiqué issued after the World Bank Annual Meeting in October 2008. This noted that the package of reforms enhancing voice and participation of all developing and transition countries (DTCs) in WBG governance and work, brought forward by the Bank's Board, addressed many aspects of voice and participation in light of the Monterrey Consensus. This was seen as an important first step in the ongoing process of comprehensive reform.

This package includes both concrete immediate steps and commitments to further work. An additional Board seat for Sub Saharan Africa on the Bank's Board will be created. DTC voting shares in IBRD and IDA will increase, giving special emphasis to smaller members. Further realignment of Bank shareholding will be taken up by the Bank's Board in an important shareholding review that will develop principles, criteria and proposals for Bank shareholding. The review will consider the evolving weight of all members in the world economy and other Bank specific criteria consistent with the Bank's development mandate, moving over time towards equitable voting power between developed and developing members.

The Board will develop proposals by the 2010 Spring Meeting and no later than the 2010 Annual Meetings, with a view to reaching consensus on realignment at the following meeting. There is considerable agreement on the importance of a selection process for the President of the Bank that is merit-based and transparent, with nominations open to all Board members and transparent Board consideration of all candidates. In addition, Bank Management has committed to continue enhancing diversity of management and staff and decentralizing decision-making. The Development Committee asked for periodic reports on progress and future proposals for a subsequent realignment of Bank shareholding as part of comprehensive reform.

Collaboration

The question of co-operation between the IMF and the World Bank has also received attention over the years. Most recently, the Malan Review Committee report in February 2007, stressed that the increased integration of economies and the emergence of many global issues, requires international institutions not only to respond to developments, but to be "ahead of the curve" and remain innovative and proactive in helping members address the challenges of globalisation.

The report illustrated examples of good collaboration, such as the Heavily Indebted Poor Countries initiative and the Financial Sector Assessment Program, emphasised that poor collaboration results in costs to donors and partners through wasted resources, poor and conflicting advice, and gaps in provision.

Subsequently, a Joint Management Action Plan (JMAP) was prepared in September 2007 covering areas such as technical co-operation and procedural changes; staff exchanges; the joint design and implementation of facilities and instruments; and collaboration on a Bank-Fund approach to fiscal policy design. The Malan report made a number of other recommendations for changes in Board composition and interaction. The first progress report is anticipated before the 2009 Annual Meetings of the IMF and World Bank boards.

The African Development Bank

The role of the AfDB was considered recently by a High Level Panel co-chaired by President Chissano and Prime Minister

Paul Martin. They reported to the AfDB President in January 2008. Their findings are very relevant to the current debate.

In brief, the HLP concluded that to reduce poverty, Africa needs sustained and shared growth, driven by the private sector, with a more equal distribution of opportunities. Without integration, the continent will remain disjointed, with many small, shallow markets that are uncompetitive on their own and unattractive to investors. Underpinning this integration are capable states, offering good and accountable governance. Progress, or the lack of it, will be closely related to success in rebuilding post-conflict states and managing fragile situations.

There is no single development model to apply. Uneven progress has made Africa more diverse, not less. Africa will need strong, committed leadership and appropriate continental institutions. The African Union is providing a political lead, but the continent needs an economic motor to facilitate implementation on the ground, to drive economic integration. The HLP recommended that the ADB should become that motor, as the premier development institution in Africa. It must be a voice for development in Africa and for Africa internationally.

The panel saw the Bank as an institution that can reduce poverty and foster development through growth and economic integration. It underscored that it had the right credentials: an elected African president, universal African membership, an exclusive focus on African development, and a strong presence on the continent, including its headquarters and growing network of country offices. It can also address the full range of Africa's challenges by supporting public and private initiatives across the continent.

The panel members recommended that the AfDB should now concentrate its resources and efforts on four interlocking flagship areas of focus, all essential for growth and economic integration: investing in infrastructure, building capable states, promoting the private sector, and developing skills. The AfDB should position itself to support African countries in managing and coordinating assistance, in accordance with their own priorities.

They believed that if the Bank had to become Africa's premier development institution, it must grow. Compared with similar institutions and, indeed, some bilateral donors, it is significantly understaffed and stretched too thin. Shareholder commitment to a cogent longer term vision for the Bank will be critical. Management and shareholders should develop a medium-term strategic accord that provides additional resources linked to specific deliverables and to performance.

Management presented a response to shareholders at the 2008 Annual Meeting in Maputo, Mozambique, and a medium term strategy has been developed accordingly.

Voice at Other Standard Setting Bodies

Like in the case of BWIs reforms, further attention should be given to building critical alliances and strategic networks and partnerships to advance the continent's development interests in international standard setting bodies such as the Basle II Committee, the Bank for International Settlements (BIS), the Financial Stability Forum (FSF). The Monterrey Consensus explicitly called on these three bodies "to continue enhancing their outreach and consultation efforts with developing countries … and to review their membership, as appropriate, to allow for adequate participation." (Paragraph 63) It is clear that very little progress has been made since the Monterrey Consensus in 2002, making it imperative for African countries to strengthen their participation in existing non-governmental bodies such as the G24. Furthermore, there is a need for Africa to forge bilateral strategic alliances with other key developing countries in South Asia (e.g. India) and Latin America (e.g. Brazil and Argentina) on these issues.

Resources

The share of multilateral aid has stayed relatively consistent for the last twenty years at between 27% and 32%, but has grown in complexity and with increased fragmentation. Some 263 international organisations are now eligible to receive ODA, up from 47 agencies in 1960 and 140 in 1980. This imposes additional transaction costs, as well as a heavy burden on those partners with weak capacity.

In 2008, multilateral aid accounted for only one quarter ($28bn) of total development aid ($117bn). A further $11bn is channeled through multilateral organizations in the form of grants or earmarked trust funds. The three largest multilateral organisations are the European Commission (EC), the World Bank and the United Nations system, accounting for 36%, 24% and 20% of core contributions respectively. The multilaterals allocate more of their resources (40%), compared to 25% from bilaterals.

Although individual DAC donors vary widely in the proportion of aid channelled through the multilateral system (only a few such as Germany have a formal cap on the amount, there is broad consensus among them on the advantages). These are seen as: economies of scale; global reach and providing public goods; standard setting; political neutrality and legitimacy; combining capital and know how; lower transaction costs and potentially more effective.

According to OECD, DAC donors value their contributions to multilateral organisations given that they cover poverty reduction; fragile states; HIV/AIDS; food security; climate change and the environment; gender equality; and education. For instance, multilateral agencies represent the majority of aid to fragile states, especially in Africa.

However there has been demand for closer co-operation between multilateral organizations and concerns over duplication of effort. Many DAC donors are, therefore, developing a stronger strategic and more focused multilateral approach. They have accepted the need for more collective action in monitoring and assessing the performance of multilateral organisations; better understanding of the duplications and gaps, as well as comparative advantages, in the multilateral system; and the need for greater system-wide coherence.

In the Paris Declaration, donors undertook to increase the effectiveness of development assistance, and to improve the alignment with country priorities. The follow-up Accra Agenda for Action last year, commits donors and developing countries to "complete good practice principles on country-led division of labour" and to "start dialogue on international division of labour across countries by June 2009".

It is clear that with demands globally for additional resources to be made available to deal with the impact of the crisis, traditional and new donors will face choices not just on the amount of resources, purpose, terms and conditions, but also through what channels this should be provided. In making decisions, relative efficiency (defined by DAC as "the extent to which a development intervention has attained, or is expected to attain, its relevant objectives efficiently and in a sustainable way") and comparative advantage will be important, but so will the views from recipient partner countries.

Response to the Crisis

The G20 will be assessing MDB responses to the current crisis. As the IMF and World Bank are represented on the G20 Working Groups, this note provides background information on the AfDB response. The AfDB proposes to provide increased support through: ADF; an Emergency Liquidity Facility; and a trade finance initiative. It will also speed up decision-making and implementation.

ADF

The aim is to accelerate resource transfers to ADF countries, targeting countries and sectors where the needs are greatest. The AfDB will review pipelines and restructure portfolios so as to release resources for early commitment and through fast disbursing instruments. It will seek supplementary resources, in the short term through co-financing from development partners for specific project investments, including multinational investments in infrastructure and critical public-private projects that otherwise would not continue. The AfDB will also consider a catalytic Trust Fund for ADF countries to provide assistance to those countries that are high performers, have demonstrated sustained commitment to decisive reforms and may, in light of the impact of the crisis, require additional financing to deliver strong results.

Emergency Liquidity Facility (ELF)

One of the biggest impacts of the current crisis is the significant liquidity crunch that is affecting the ability of countries and financial institutions to implement or pursue their development and commercial activities. The Bank proposes to establish an Emergency Liquidity Facility (ELF), tentatively set at USD 1.5 billion, but subject to a review on the basis of actual demand. The ELF is expected to provide eligible beneficiaries with the means to meet urgent liquidity needs, within a fast turnaround time and with appropriately designed conditionalities.

The ELF will function as a revolving facility, disbursed in USD or Euro. It will operate on the basis of "first come, first served" with an initial cap of USD 150 million per country (subject to review), consisting of sovereign guaranteed or possibly non-sovereign guaranteed transactions.
The ELF will be available to a broad range of eligible beneficiaries, including Central Banks, for on-lending to public and private financial institutions, public and private financial institutions with proven market access before the crisis, and a large presence in domestic and regional economies. The proposed use of funds under the ELF would be relatively broad and could cover, debt service obligations, borrowers' requests for disbursement in case of FI or payments that are critical and/or take advantage of new developmental business opportunities. The facility is intended to operate as a "last resort" type of facility. Its use should be limited to exceptional circumstances and not as a substitute to normal funding sources.

Trade Finance Initiative

The global financial crisis has crippled many international banks that are involved in financing trade as confirming banks. Higher credit rating thresholds and sharply reduced credit limits are now applicable for African banks that facilitate the import and export of goods. This is having a detrimental effect and is restricting credit and threatening Africa's vital trade flows. As a direct and immediate response to this situation, the Bank intends to announce its intention to support trade finance through a new USD 1 billion trade finance initiative (TFI).

The initiative could include Trade Finance in Approved Letters of Credit to Banks, under new Lines of Credit for Trade Finance, including through Development Finance Institutions and other Trade Organizations.

These responses would, of course, require additional resources. The AfDB's assessment is that such increased lending would bring the Bank to its agreed prudential limits. Although the Bank currently has significant unused risk capital (50%), it needs additional risk-bearing capacity in the future to sustain additional risks, in order to further increase lending, particularly to adequately respond to this crisis and to continue to sustain net income transfers to development initiatives.

The projected financial position indicates that in order for the Bank to fulfil its development mandate while remaining a financially strong institution, a strategy for future capital increases should be considered. A capital increase would therefore become necessary to provide the Bank with the capacity to respond appropriately to the financial and economic crisis

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3. Way Forward

The Ministerial Conference in Tunis was a necessary initiative designed to build a framework for African countries to debate at higher levels and generate harmonized positions on voice issues that can be taken to forums such as the G20. Such discussions should also be broadened to facilitate the exchange of ideas in areas such as sharing experience in the implementation of Basel II, trade policy issues in the WTO, discussions in forums where some African countries participate as observers (e.g., OECD) or as invited guests (e.g., G8).

The development partners support will be critical in providing technical assistance to African countries, to strengthen their voice, representation and effective participation at BWIs and other standard setting bodies. Ministers and Governors will want to consider key priorities for the continent, taking into account, the range of forums, the sequencing of meetings, and develop a strategy to influence discussions.

Other Publications in the Series

N° 1/2008 : The Current Financial Crisis: Impact on African Economies, November 2008.

N° 1/2009 : Impact of the Financial Crisis on African Economies - An Interim Assessment, January 2009.

N° 2/2009 : Preventing a Credit Crunch in Africa : The Role of Financial Regulation, January 2009.

African Development Bank

Angle de l'avenue du Ghana et des rues Pierre
de Coubertin et Hédi Nouira
BP 323 - 1002 Tunis Belvédère (Tunisia)
Tel.: + 216 71 333 511 - Fax: +216 71 351 933
E-mail: afdb.org - Internet: www.afdb.org