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Recession impact

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In his inaugural address on January 20, President of the world's largest economy promised a "new era of responsibility" for rebuilding the economy and restoring America's standing in the world.

Yet, his stimulus package, passed after acrimonious debate in the American legislature, has nothing to offer to the world.

Certainly, Asia-Pacific was not the epicenter of the current crisis.

Asia-Pacific countries have nothing to do with causes behind the financial meltdown.

It was all due to the failure of financial institutions in America, their reckless greed and poor regulation by central banks and other regulatory agencies. The recession in advanced countries has already spread, inflicting severe pain outside their frontiers.

Fall in their imports from poor countries has spelt gloom. Consequent decline in commodity prices have resulted in lower export earnings, which left poor countries high and dry. Developing countries , which depend on primary and processed products are hit hard.

The US stimulus package has a provision that public funded projects will use only American goods: iron and steel and manufactured products, adversely hurting prospects of export recovery in developing countries.

No doubt, not all Asia pacific countries export iron and steel to USA.

Downturn in Asia- Pacific region

"Still the magnitude and speed of the downturn is astounding in the Asia-Pacific region," says an International Labour Organisation (ILO) spokesperson.

The Asian Development Bank (ADB) in December 2008 cut its economic growth forecasts for the region from 6.9 per cent last year to 5.8 per cent this year. More cut is coming soon.

Self-employed people and unpaid family workers – whom the ILO consider "vulnerable" because they lack social benefits, will increase by 21 million, if current conditions hold or by 60 million if the situation worsens further.

Besides commodity exports, in 2008 developing countries all over the world have also lost substantial remittance inflows. The ILO has estimated 50 million job losses for migrant workers in rich countries.

Every advanced country is trying to protect itself by fiscal spending initiatives, having seen that monetary policy initiatives have not been effective.

Following the US example, Germany approved on February 20, a 50 billion euro (US $63bn) stimulus plan aimed at boosting Europe's largest economy. The United States with its US $787 billion fiscal stimulus package would be borrowing overseas, especially from China, which has built current account surplus. China has already been financing USA's current account deficits by investing in US long term bonds.

That has worldwide implications.

In the midst of worldwide credit crunch, only sovereign funds will flow. Interest rate in capital markets would rise, crowding out developing countries.

World Bank to rescue

The World Bank is aware of the intense predicament of poor countries.

Writing in ***Financial Times of London in January***, the World Bank President Robert Zoellick highlighted the tasks before the advanced countries.

Aside from fiscal responsibility, financial sector regulations and shunning protectionism, Zoellick suggested developed countries devote 0.7 per cent of their stimulus packages to a vulnerability fund to support the neediest in developing countries.

World Bank President argued: "A target of providing 0.7 per cent of each developed country's stimulus package represents only a tiny fraction of the hundreds of billions devoted to bank bail-outs, yet it could make a significant difference to the hundreds of millions who are victims of a crisis not of their making. Most important, it would signal a commitment that the world is choosing to define, rather than be defined by the crisis".

This might amount to US $15 billion.

Zoellick offered that World Bank would manage the distribution of the cash with the United Nations and the regional development banks, including Asian Development Bank. He said: "The World Bank would use existing mechanisms to deliver the funds fast and flexibly, backed by monitoring and safeguards so the money is well spent".

There is no response yet from America.

Japan is the only country, which came up with a positive response.

It announced at Davos that it would increase its assistance by US $17 billion and probably put it into ADB for providing assistance.

It is likely that the subject of providing loan assistance to poor countries with cash would be taken up by the April 2009 London Summit of World's 20 Government Leaders, known as G-20.

Fiji's situation

Fiji is in the same boat along with a large number of developing nations.

Consequent to 2008's food and fuel price shocks, Fiji has been facing fiscal crisis similar to the ones faced by other Asia-pacific countries. Global recession has contributed to reduction in government revenues, thereby reducing its ability to meet education, health and other social development goals.

The three interventions proposed by the World Bank, namely safety net programmes to help cushion the impact of the downturn on the poor; investment in infrastructure to build a foundation for productivity and growth while putting people to work; and finance for small and medium-sized enterprises to create jobs are all now beyond reach.

With declining revenues and falling remittances, together with stagnant foreign and domestic investment since 2007, Fiji cannot afford to emulate the example of fiscal expansion by advanced countries or China, which has built huge trade surplus over decades of export promotion. Any expansionary fiscal policy at this stage, without backing of sufficient resources, including international reserves, would be inflationary, as well aggravating exchange market pressure.

Fiji's imports to meet essential food and fuel and other strategic needs are increasing.

As the Reserve Bank of Fiji (RBF) Economic Review for January 2009 noted, widening trade deficits are exercising pressures on international reserves. Official foreign reserves stood at around $737.5 million (provisional), sufficient to cover 3.0 months of imports of goods only.

A decline in foreign reserves in an economy under a fixed exchange rate regime, as we have in Fiji, would lead to fall in money supply, given the domestic credit. Money supply is defined as a sum of net foreign assets and domestic credit as a result of consolidation of balance sheets, of commercial banks and of central bank, known as monetary survey.

According to RBF Economic Review for January 2009, broad money (defined as currency and demand deposits plus saving and time deposits with commercial banks), contracted in November by an annual 3.3 percent, as there was a fall in international reserves. Reflecting the tightening of liquidity, average lending rate rose to 8.45 percent.

In a short term response in January 2009, RBF reduced the discount rate by almost half for encouraging commercial banks to borrow from central bank. Secured borrowing rate was reduced from 6 percent to 3 percent; and unsecured borrowing rate was reduced to 11 percent from 16 percent.

Offshore borrowing option

The central bank governor is reported to be in favour of external borrowing over domestic borrowing. Borrowing from overseas achieves two objectives. It will help adding to international reserves, as it is in foreign exchange as well as increasing money supply, since increase in net foreign assets would contribute to rise in money supply.

According to ***Global Development Finance 2008 Report*** of the World Bank, Fiji's external debt level is one of the lowest among developing countries: it is only 8 percent of gross national product. However, it is not the level of debt which is important, as debt financing in future would involve transfer of real resources by way of foreign exchange.

As debt servicing has to be done in foreign exchange, export earnings capacity in the future becomes critical. The relevant ratio is debt -servicing expenditure as percentage of exports of goods and services, which include tourism. Fiji's debt servicing ratio is less than 1 percent.

Thus, Fiji's current external debt burden is very low and in normal circumstances, Fiji is a safe bet in the capital markets.

In fact, such a record of high credibility helped Fiji to successfully float its first-ever international bond in 2006 for US $150 million, which was oversubscribed.

Borrowing from international agencies such as ADB and World Bank do not immediately lead to rise in international reserves, as loans are generally for projects or programmes. First, approval of loan projects takes a lead time of nine months to one year. Secondly, borrowing countries have to spend on project/programme components from their own resources and file applications for reimbursement later.

Only, emergency assistance for disasters such as earthquakes/cyclones and the like, can one get the funds upfront.

Another international bond?

If Fiji were to float another bond in Singapore, which alone would add to reserves immediately, international capital market conditions have to be recognized.

Capital market conditions are tighter than ever before, because of the current worldwide credit crunch.

Furthermore, Fiji's international ratings by credit agencies, by Moody's and Standard and Poors, are less favourable today than they were in 2006.

Moody's have downgraded Fiji's Foreign Currency Long term Debt from Ba2 to Ba2- (negative).

Standard and Poors have downgraded Fiji's Foreign Currency Long Term Debt from BB in 2006 to B.

The latest news released on February 18 says that Moody's have put Fiji on "negative watch" list.

The indications are that prospects of a successful international bond float, similar to the 2006 float do not look bright as they were in 2006.

So, the alternative is as Governor is reported to have said: "We can buy time…Meanwhile, we need to do what we need to do economically to boost our exports with some of the export potential that we have. We need to do a lot of things to make it happen."

Developing countries are awaiting the decision of developed countries on the World Bank suggestion to set aside 0.7 percent of their fiscal stimulus packages.

If the developed countries do not act, the much awaited "Era of Responsibility" would become "an Era of Empty Rhetoric".

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