Building national risk mitigation strategies in LDCs to reduce their vulnerabilities to economic shocks

Brainstorming meeting on the way forward for the implementation of the Istanbul Programme of Action for the Least Developed Countries

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OUTLINE OF THE PRESENTATION

- Definition of Economic Shocks
- Factors that determine the impact of economic shocks
- Rationale and definition of national risk mitigation strategies
- Set of Policies at the Macro Level and at the Micro Level
Definition of Economic Shocks

- **Shocks that are related:**
  - International commodity prices, market conditions, or access to trade partner markets (both imports and exports)
  - Capital Flows (FDI, Portfolio Investment)
  - Aid
  - Interest rates and exchange rates

- The notion of economic shocks can sometimes blurred other types of shocks (natural shocks, conflict-related shocks...)
Factors that determine the impact of the economic shocks?

- The magnitude and frequency of the shocks
- The level of exposure to shocks
- The capacity to cope with the effects of the shocks
Rationale and definition of national risk mitigation strategies

- To Influence:
  - The level of exposure to shocks
  - The capacity to cope with the effects of the shocks

- National risk-mitigation strategies = a set of self-insurance policies

- These self-insurance policies:
  - Macro-oriented policies
  - Micro-oriented policies

- Policies that help reduce output and employment losses (smooth out business cycles) and preserve social gains.
Macro Level

- Revert to fiscal, monetary and exchange rate policies
- Countercyclical fiscal policy:
  - Save revenue windfalls during good times and draw on these buffer reserves when confronted with negative shocks;
  - Supportive instruments to support counter-cyclical fiscal policies (Fiscal Rules and Stabilization Fund)
  - Success depends on: i) Strong legislative restrictions on how government can use the Funds; ii) on a strict adherence to the fund’s enabling legislation
Macro (Cont’d)

- Countercyclical monetary policy:
  - Loose monetary policy when confronted with negative shocks and tightening when confronted with positive shocks;
  - Monetary policy not subservient to price stability objectives only but also to real objectives (economic growth, employment)

- Flexible exchange rate regimes (the use of exchange rate to cushion impact of shocks)
Well-targeted social safety net schemes (food-for-work programmes, conditional cash transfers, the expansion of school feeding programmes, the quick provision of agricultural inputs (seeds, fertilizer), the elimination of school fees, the reduction or the removal of tariffs on a limited number of staples and type of fuel.

Caveats (High transaction costs, financial sustainability, balanced incentives)
Micro Level (Cont’d)

- Financial risk-management tools (Forward Contracts, Futures and Options)
- Challenge: Access to these instruments in the context of LDCs
Concluding Remarks

- National risk mitigation strategies will not be enough to reduce the vulnerabilities to economic shocks.
- International Dimension is important, particularly in reducing the size and the frequency of the economic shocks but also in improving the ability to mitigate the impact of shocks.
THANK YOU FOR YOUR KIND ATTENTION